



Durham E-Theses

The Role of Blockholders in the Governance of Saudi Public Listed Companies

AKEEL, YUSUF,NASSER

How to cite:

AKEEL, YUSUF,NASSER (2018) *The Role of Blockholders in the Governance of Saudi Public Listed Companies*, Durham theses, Durham University. Available at Durham E-Theses Online:
<http://etheses.dur.ac.uk/12599/>

Use policy

The full-text may be used and/or reproduced, and given to third parties in any format or medium, without prior permission or charge, for personal research or study, educational, or not-for-profit purposes provided that:

- a full bibliographic reference is made to the original source
- a [link](#) is made to the metadata record in Durham E-Theses
- the full-text is not changed in any way

The full-text must not be sold in any format or medium without the formal permission of the copyright holders.

Please consult the [full Durham E-Theses policy](#) for further details.

Academic Support Office, Durham University, University Office, Old Elvet, Durham DH1 3HP
e-mail: e-theses.admin@dur.ac.uk Tel: +44 0191 334 6107
<http://etheses.dur.ac.uk>

The Role of Blockholders in the Governance of Saudi Public Listed Companies

By:

Yusuf N. Akeel

A thesis submitted to Durham University Business School in
fulfillment of the requirements for the degree of Doctor of
Philosophy

Durham University Business School

2018

Abstract

This thesis investigates the role of blockholders in the governance of Saudi public listed companies. Saudi Arabia presents a unique setting, where religious, cultural and social factors, that are similar to those of other Arab and Islamic nations, play an important role in the day to day lives of the society. Similar to other developing countries, Saudi Arabia is characterized by a wide presence of blockholders in addition to a weak legal setting, in such context minority shareholders become prone to expropriation by controlling blockholders.

In order to examine the level of influence blockholders have on corporate governance, three empirical chapters, chapters 3, 4 and 5, focus on key governance mechanisms that concern minority shareholders, namely the board of directors, dividends and audit quality, respectively. Using appropriate regression models, each study examines the influence of the different blockholder types present in the Saudi market, namely family, royal family, government, corporate, managerial and multiple blockholders, while controlling for various factors that are known to have an impact on the governance measures in question. The studies examine data from 117 non-financial listed companies in Saudi Arabia from 2008-2013, with a final sample (N) of 619 firm year observations.

Overall, the results show that minority shareholder rights are fairly protected under blockholder control in Saudi public listed companies. The initial results, in chapter 3, indicate that blockholders reduce board independence and maintain control over board representation, which enables them to expropriate minority shareholders. The exclusion of outside independent directors might reflect the dominance of the Arabian culture in Saudi Arabia, which is characterized by high power distance and strong levels of secrecy in business dealings. However, further analyses, in chapters 4 and 5, reveal that blockholders actually act in the best interest of all shareholders and curb managerial self serving behavior by positively influencing the corporate governance of the firm, through improved dividend payout policy, which reduces the levels of free cash flow available for appropriation, as well as improving the firms' audit quality, by appointing Big Four auditors and independent and expert audit committee members.

Collectively, these results reflect the possible role that Islamic teachings play in shaping the behavior of blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values, in which minority shareholders are not found to be expropriated. The Islamic ethical system promotes the protection of the rights of the various stakeholders and urges humans to act as stewards entrusted in achieving continuity and societal welfare.

The results of the thesis are of interest to academics, practitioners and policy makers in developing countries in general, and the Middle East and Saudi Arabia in particular. Local and international investors become more aware of the environment of the Saudi market when prompted to make investment decisions. Policy makers also recognize the relationship between blockholders, corporate governance and minority shareholders in the Saudi market.

Table of Contents

Abstract.....	ii
Declaration	vi
Statement of Copyright.....	vi
Acknowledgment.....	vii
Chapter One Introduction.....	1
1.1 Research Background	2
1.1.1 Corporate Governance Defined.....	2
1.1.2 Blockholders and the Principal-Agent Problem.....	5
1.1.3 Blockholders and the Principal-Principal Problem	6
1.1.4 Corporate Governance Mechanisms	9
1.2 Research Context and Motivation.....	12
1.3 Research Questions.....	14
1.4 Research Philosophy.....	16
1.5 Contribution to Knowledge.....	21
1.6 Thesis Structure	22
Chapter Two Overview of Saudi Arabia	23
2.1 Introduction	23
2.2 Background to Saudi Arabia	23
2.2.1 Brief History.....	23
2.2.2 Geography and Demographics	24
2.3 Economy.....	27
2.3.1 Oil Based Economy.....	27
2.3.2 Saudi Vision 2030	28
2.4 Saudi Stock Market - TADAWUL.....	30
2.5 Regulatory Framework	32
2.5.1 Islamic Law and Sharia.....	32
2.5.2 Capital Market Regulation.....	33
2.6 Corporate Governance in Saudi Arabia	38
2.6.1 Corporate Governance and Islamic Sharia.....	38
2.6.2 Corporate Governance and Saudi Law.....	45
2.6.3 Corporate Governance in Practice.....	47
2.7 Conclusion	50
Chapter Three Blockholders and the Structure of the Board	53
3.1 Introduction	53
3.1.1 Research Context and Background.....	53
3.1.2 Research Motivation and Significance	55
3.1.3 Functioning of the Board	56
3.1.4 Literature Gap	58
3.2 Theoretical Framework	60
3.2.1 Agency Theory	60
3.2.2 Stewardship Theory	63
3.2.3 Resource Dependence Theory.....	67
3.3 Literature Review and Hypotheses Development	70
3.3.1 Family Blockholders.....	78
3.3.2 Royal Family Blockholders	81
3.3.3 Government Ownership.....	82
3.3.4 Corporate Ownership.....	84
3.3.5 Managerial Ownership	85

3.3.6 Multiple Blockholders.....	87
3.4 Research Methodology	90
3.4.1 Sample Selection	90
3.4.2 Variable Measures	91
3.4.3 Model Specification.....	97
3.5 Results and Discussion	100
3.5.1 Descriptive Statistics	100
3.5.2 Discussion of Results.....	107
3.5.3 Robustness Checks	115
3.6 Conclusion	119
Chapter Four Blockholders and Dividend Policy	123
4.1 Introduction	123
4.1.1 Research Context and Background.....	124
4.1.2 Research Motivation and Significance	125
4.1.3 Literature Gap	127
4.2 Theoretical Framework	130
4.2.1 Tax Effect Hypothesis.....	131
4.2.2 Agency Theory	132
4.2.3 Signaling Theory	134
4.3 Literature Review and Hypotheses Development	137
4.3.1 Family Blockholders	147
4.3.2 Royal Family Blockholders	149
4.3.3 Government Ownership.....	151
4.3.4 Corporate Ownership.....	154
4.3.5 Managerial Ownership	155
4.3.6 Multiple Blockholders.....	157
4.4 Research Methodology	160
4.4.1 Sample Selection	160
4.4.2 Variable Measures	161
4.4.3 Model Specification.....	166
4.5 Results and Discussion	170
4.5.1 Descriptive Statistics	170
4.5.2 Discussion of Results.....	174
4.5.3 Robustness Checks	186
4.6 Conclusion	190
Chapter Five Blockholders and Audit Quality	194
5.1 Introduction	194
5.1.1 Research Motivation.....	194
5.1.2 Research Context	198
5.1.3 Research Gap	201
5.2 Theoretical Framework	203
5.2.1 Agency Theory	205
5.2.2 Resource Dependence Theory.....	206
5.2.3 Signaling Theory	210
5.3 Literature Review and Hypotheses Development	212
5.3.1 Family Blockholders	221
5.3.2 Royal Family Blockholders	224
5.3.3 Government Ownership.....	227
5.3.4 Corporate Ownership.....	230
5.3.5 Managerial Ownership	231
5.3.6 Multiple Blockholders.....	234
5.4 Research Methodology	237
5.4.1 Sample Selection	237

5.4.2	Variable Measures	238
5.4.3	Model Specification.....	242
5.5	Results and Discussion	245
5.5.1	Descriptive Statistics.....	245
5.5.2	Discussion of Results.....	249
5.5.3	Robustness Checks	263
5.6	Conclusion	265
Chapter Six	Conclusion	269
6.1	Introduction	269
6.2	Findings and Discussion.....	272
6.3	Contributions and Implications	277
6.4	Limitations and Future Research.....	279
References		282
Appendix A – Saudi Corporate Governance Regulations (CGR)		303

Declaration

This thesis benefited from feedback received for parts that have been presented in conferences, namely: 'The Henley Centre for Governance, Accountability & Responsible Investment (GARI) Conference 2016', 'BAFA Doctoral Conference 2016', and 'Alternative Business Perspectives: Understanding and Analysing the Post-Crisis Business Environment 2016'. This thesis also benefited from comments received from a revise and resubmit from the 'Journal of Management and Governance' for parts that was sent as a journal article.

Yusuf Binakeel

Statement of Copyright

"The copyright of this thesis rests with the author. No quotation from it should be published without the author's prior written consent and information derived from it should be acknowledged."

Yusuf Binakeel

Acknowledgment

All praise be to Allah for His countless blessings, and for giving me the opportunity, strength, courage and patience to complete my PhD studies. There are many people that have helped me throughout this long journey.

Firstly, I would like to thank my parents, *Nasser* and *Maha*, for their infinite support and encouragement in all stages of my life, I shall forever remain indebted for all they have done for me.

I would also like to express my deepest gratitude to my wonderful supervisors, *Prof. Rob Dixon* and *Dr. Riham Rizk*, for their continuous guidance and support during my studies. Their patience and wisdom helped me overcome difficult times and continue with my research in order to produce this piece of work.

My appreciation also goes to the many friends that I have had the pleasure to know during my time in Durham through my Master and PhD studies. *Rahim, Dr. Al-Ali, Dr. Moqbel, Dr. Yavuz, Dr. Aljuaid, Dr. Alonazi, Dr. Hertenstein, Tashfeen, Urxan, Jared, Ghanem, Farhan, Abdullah, Ali, Dr. Helmi, Dr. Alhamood, Dr. Marriot, Ustinov College FC, the staff at Durham University Business School and the Doctoral Office*, and many others who truly have a special place in my heart.

Furthermore, I would like to thank my colleague *Dr. Mosaab Aljuaid* for the many interesting discussions we had on corporate governance and for helping me in the data collection process. Additionally, I would like to thank my examiners, *Prof. Mehmet Asutay* and *Dr. Tarek Abdel-Fattah* for their valuable time and helpful comments. I would also like to thank *Dr. Rebecca Stratling* for supervising the early stages of my PhD.

I would like to extend my appreciation to my family and friends back home in Saudi for always asking about me and wishing me all the best. My brothers, *AbdulAziz, Hashim, Mansour* and *AbdulMajeed*, my Sister, *Roaa*, my grandparents, uncles, aunts, cousins, parents in-law and brothers and sisters in-law, thank you all. A special mention goes to *AbdulRahman Al-Ohaly, Mansour Atallah, Mohammed Al-Amri, Sattam Albawardi* and *Trad Kamakhi*, your names had to be here buds.

Last but certainly not least, I would like to express my warmest gratitude to my lovely wife, *Nouf*, and two princesses, *Maha* and *Mona*, for showing me all the love I need and for being patient and caring always, I dedicate this work to you.

Chapter One

Introduction

In contrast to the classical view of corporate governance, which is based on the premise of dispersed ownership structures (Fama & Jensen, 1983; Jensen & Meckling, 1976), recent studies show that the presence of blockholders¹ is far more common in most countries around the world (Denis & McConnell, 2003; La Porta et al., 1999; Holderness, 2010). Due to their strong position of high voting power, blockholders are assumed to have great influence over the governance and ultimate performance of corporations (Daily, Dalton, & Rajagopalan, 2003; Shleifer & Vishny, 1997; Thomsen, Pedersen, & Kvist, 2006).

Given their dominant position and tied wealth, blockholders are expected to help firms by engaging in managerial monitoring that leads to better performance outcomes (Connelly et al., 2010). However, as blockholders normally hold uncontested voting power, they might also expropriate firm's resources at the expense of minority shareholders (Djankov et al., 2008). The interests of blockholders, whether economical or political, might greatly differ from that of minority shareholders. Consequently, minority shareholders rely on different means of governance to protect their invested wealth, especially in a less developed country such as Saudi Arabia (Huyghebaert & Wang, 2012; Djankov et al., 2008; Dyck & Zingales, 2004).

¹ Blockholders, also known as large/controlling shareholders, are dominant shareholders of public listed companies. While there is no universally accepted threshold that defines a blockholder, studies have mostly used the minimum disclosure requirement of significant ownership, such as 3% or 5%, to identify a blockholder (Edmans, 2014; Holderness, 2007).

This thesis studies the role of blockholders in the governance of Saudi public listed companies. This introductory chapter will provide a brief background to the main topics of the thesis, namely corporate governance and the role of blockholders. The motivation behind the chosen study and research context will follow. Finally, the research questions investigated, the research philosophy employed and the contribution to knowledge the thesis aims to offer will be presented.

1.1 Research Background

1.1.1 Corporate Governance Defined

Corporate governance deals with the control systems associated with firms characterized by a separation in their ownership and control rights, e.g. public listed companies (Denis & McConnell, 2003). In such form of incorporation, the rights of ownership and control remain separated (Fama & Jensen, 1983). Shareholders, being the rightful owners, delegate the control rights to professional managers, who in turn run the day to day operations of the firm.

Corporate governance has attracted a great deal of interest in the past twenty years from both academics and practitioners alike (Daily, Dalton & Cannella, 2003; Brown et al., 2011). This is generally attributed to the significance of public listed companies in today's economy, as the invention of public listed companies "has provided vast employment, fuelled huge economic growth and created untold wealth" (Tricker, 1993, p.2). Furthermore, major corporate

scandals, from the likes of ENRON, WorldCom and Lehman Brothers, fostered additional interest to better govern corporations (Brown et al., 2011).

One of the earliest definitions of corporate governance is that provided in the Cadbury Report (Cadbury, 1992). The Cadbury report presented a set of guidelines and recommendations for listed companies in the UK, and is generally considered as the foundation of the development of corporate governance codes around the world (Zattoni & Judge, 2012).

Cadbury (1992, p.14) defines corporate governance as “the system by which companies are directed and controlled”. However, there is no single agreed upon definition for corporate governance amongst scholars nor professionals, despite the fact that the topic attracted great interest from academics and regulators for more than two decades (Brown et al., 2011). This is generally attributed to the fact that corporate governance has been approached from a wide range of disciplinary perspectives, ranging from economics, management and finance to politics, law and sociology (Aguilera & Jackson, 2010).

Nevertheless, most definitions, in one way or another, encompass the role of different governance mechanisms in safeguarding the interests of principals through value creation (Huse, 2007). The main difference in defining corporate governance lies in who is regarded as the principal. The financial literature, of shareholder primacy, and the socially responsible ethical literature, of stakeholder eminence, are the two major standpoints which represent the opposite ends of the spectrum (Gillan, 2006; Huse, 2007).

The economics and finance view regards principals as solely shareholders, and that the objective of organizations is shareholder wealth maximization. In this view, the role of the various governance mechanisms is to protect the interests of shareholders from managerial misconduct. Based on this narrow perspective Shleifer & Vishny (1997, p.737) states that “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. Grounded in agency theory, the objective of corporate governance, in this case, is to align managerial interests with that of shareholders in order to maximize shareholder value.

The stakeholder perspective, on the other hand, encompasses the various, internal and external, continuities to the organization in aim of achieving value creation to all related parties. Huse (2007, p.15) defines corporate governance as “the interaction between various internal and external actors and the board members in directing a firm for value creation”, without clearly defining who the value is created for. Similarly, Solomon (2010, p.14) defines corporate governance as “the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity”.

Even though corporate governance has numerous definitions, they generally encompass the basic assumptions of value creation and wealth preservation (Huse, 2007). There is, therefore, no right or wrong definition of corporate governance, it basically depends on one’s view of the world (Gillan, 2006).

1.1.2 Blockholders and the Principal-Agent Problem

Agency theory, being the most applied theory in the corporate governance literature (Dalton, Hitt, Certo, & Dalton, 2007), explains the relationship between the shareholders [principals] and managers [agents] (Fama & Jensen, 1983; Jensen & Meckling, 1976). Under the assumption that both parties are utility maximizers, in addition to the information asymmetry that exists between them, chances of agents acting in an opportunistic manner increases. Creating an environment where “important decision agents do not bear a substantial share of the wealth effects of their decisions” (Fama & Jensen, 1983, p. 301). As such, this agency theory was the first theoretical framework to adequately explain the existence and development of public corporations, given its unique separation of ownership and control arrangement (Daily et al., 2003).

Small-dispersed shareholders are generally expected to be diversified through small ownership stakes in numerous firms. Such an ownership structure causes free-rider problems (Grossman & Hart, 1980). Small shareholders are expected to suffer from shareholder apathy, due to their insufficient power and economic incentives to monitor the management, and therefore tend to rely on free-riding (Shleifer & Vishny, 1986; Denis & McConnell, 2003).

By contrast, large shareholders possess greater power to intervene in case managers diverge from the shareholder maximization goal (Becker, Cronqvist, & Fahlenbrach, 2011; Jensen & Meckling, 1976; Shleifer & Vishny, 1986). Additionally, shareholders with high cash flow rights tied to the firm have greater incentives to monitor the management in order to protect their wealth

(Shleifer & Vishny, 1986), especially in countries with weak legal shareholder protection (La Porta et al., 1998).

This monitoring by blockholders results in shared benefits of control by all other shareholders against managerial self-serving behavior, in the form of excessive perquisites, appointment of nonqualified individuals or any other form of appropriation (Shleifer & Vishny, 1986; Becker et al., 2011; Shleifer & Vishny, 1997). Blockholders, therefore, are expected to improve firm value by aligning the interests of managers with that of shareholders, as well as reducing the cost of monitoring of management via other mechanisms (Wang & Shailer, 2015; Shleifer & Vishny, 1997).

1.1.3 Blockholders and the Principal-Principal Problem

As opposed to the shared benefits of control, the private benefits of control occur when blockholders abuse their power and expropriate the firm's resources (Chang, 2003; Djankov et al., 2008; Jiang et al., 2010; Barclay & Holderness, 1989). Consequently, blockholders reduce firm value by engaging in expropriating behavior at the expense of minority shareholders (Huyghebaert & Wang, 2012).

There are various forms expropriation, such as direct or indirect extraction of physical resources, tunneling, misallocation of key organizational positions to family or group related personnel, or to follow strategic decisions that advance personal goals and political agendas at the expense of firm performance (Chang, 2003; Djankov et al., 2008; Jiang et al., 2010; Barclay & Holderness, 1989; Denis & McConnell, 2003; Young et al., 2008; Huyghebaert & Wang, 2012).

These private benefits of control generates a new type of agency problem between the controlling and minority shareholders, instead of the basic agency problem between the management and shareholders (Young et al., 2008). This so called principal-principal agency problem is prevalent in countries characterized with the presence of controlling shareholders as well as a weak legal framework (La Porta et al., 1999).

The Law and Finance literature argues that the strength of a country's legal system, in terms of shareholder protection, is what ultimately shapes its ownership structure (La Porta et al., 1998; La Porta et al., 1999). In a weak regulatory environment, concentrated ownership can serve as a substitute mechanism to protect one's investment from managerial misconduct.

However, a weak regulatory environment exacerbates the problem of minority shareholder expropriation by blockholders, as blockholders face less pressure from legal punishment for their actions (Adams & Ferreira, 2008). Therefore, while in dispersed ownership structures the main agency problem is seen as being between shareholders and managers [P-A], in a weak legal system with concentrated ownership, the problem shifts between controlling and minority shareholders [P-P] (Young et al., 2008).

In contrast to the classical view of corporate governance, which is based on the premise of dispersed ownership structures (Fama & Jensen, 1983; Jensen & Meckling, 1976), it has been found that blockholders are present in most

countries around the world (Denis & McConnell, 2003; La Porta et al., 1999; Holderness, 2010). Given their dominant position, blockholders are expected to help firms by engaging in managerial monitoring that leads to better performance outcomes (Connelly et al., 2010). Studies show that firms with family blockholders had better performance than firms with dispersed ownership, especially when a member of the family serves as the CEO (Anderson & Reeb, 2003; Villalonga & Amit, 2006). However, as blockholders normally hold uncontested voting power, they might also expropriate firm's resources at the expense of minority shareholders (Djankov et al., 2008).

Blockholders, therefore, are assumed to have great influence over the governance and ultimate performance of corporations (Daily, Dalton, & Rajagopalan, 2003; Shleifer & Vishny, 1997; Thomsen, Pedersen, & Kvist, 2006). While, theoretically, owning a majority ownership of more than 50% enables the blockholder to control the outcome of elections, there is no minimum expected level for the blockholder to be able to exert influence over corporate decision making in practice (Shleifer & Vishny, 1986; Edmans & Holderness, 2016).

There is no generally accepted definition of blockholders, however, the literature mostly considers blockholders based on the minimum disclosure requirement of the market in question, such as 5% in the US and 3% in the UK (Edmans, 2014; Lasfer, 2006; Shleifer & Vishny, 1986; Short & Keasey, 1999). Other studies have considered higher ownership levels, such as 10% or 20% in identifying a controlling blockholder (Claessens et al., 2000; Faccio & Lang, 2002;

Holderness & Sheehan, 1988; La Porta et al., 1999), however, there is no theoretical foundation for any of these thresholds (Edmans & Holderness, 2016).

In order to maintain consistency with most prior literature (Edmans, 2014; Cronqvist & Fahlenbrach, 2009; Holderness, 2003), this thesis will consider the minimum disclosure requirement of the Saudi market, which is 5%, as the minimum level for the different types of blockholders (CMA, 2010), however, different cut-off points will also be investigated in each empirical chapter, in order to identify the level of ownership required to maintain control in Saudi PLCs.

1.1.4 Corporate Governance Mechanisms

Corporate governance mechanisms have evolved over time, due to the rise of public listed companies and as a consequence of several corporate scandals and failures that hit different parts of the world. These mechanisms aim at alleviating the agency problems inherent in corporations characterized by a separation of ownership and control (Denis & McConnell, 2003).

Corporate governance mechanisms can be either internal or external to the organization. Internal governance mechanisms include the board of directors, debt financing, dividends, compensation contracts and blockholder monitoring. External governance mechanisms include the takeover market and legal shareholder protection (Daily, Dalton & Cannella, 2003; Durisin & Puzone, 2009). The development of, and interaction between, these various mechanisms are the primary focus of corporate governance research (Denis & McConnell, 2003).

1.1.5 The Board, Dividend Policy and Audit Quality

External governance mechanisms, such as the take over market, are generally inactive in less developed countries, due to the weak legal system in such contexts (Mishra, 2011). In emerging and developing countries, laws and regulations regarding the governance of corporations are either absent entirely or cannot be effectively enforced (Yoshikawa et al., 2014). As a result, internal governance mechanisms, such as the board of directors, become significant in assuring shareholders' interests in the context of developing countries (Douma et al., 2006; Munisi et al., 2014).

Likewise, Setia-Atmaja et al. (2009) argue that external governance mechanisms fail to control principal-principal agency problems, and that "other internally determined governance mechanisms (i.e., dividends, debt and board structure) may prove more significant in controlling Agency Problem II [P-P]" (Setia-Atmaja et al., 2009, p.864). Furthermore, the level of audit quality, both internal and external audits, reflect the credibility of accounting information minority shareholders obtain under controlling ownership structures and increase confidence in these reports (Lin & Liu, 2009). Therefore, audit quality is expected to reduce the information asymmetry between controlling insiders and minority shareholders by providing credible checks to the financial reports of the company, thus, further alleviating P-A and P-P agency problems (Cohen et al., 2002; Fan & Wong, 2005; Lin & Liu, 2009).

This thesis will investigate the relationship between key governance mechanisms that are expected to alleviate both P-A and P-P agency problems

and blockholder ownership in Saudi Arabia in order to reflect the level of protection minority shareholders experience under blockholder presence. The three governance mechanisms analyzed are: the structure of the board of directors; dividend policy and audit quality. The choice of these mechanisms is motivated by several factors.

Firstly, the board of directors is regarded as the most significant governance mechanism (Daily, Dalton & Cannella, 2003). Similarly, Fama (1980, p.294) views the board of directors as the “ultimate internal monitor”. The board of directors has the power to hire, fire, and compensate top executives (Fama & Jensen, 1983). Furthermore, Anderson and Reeb (2004) argue that in closely controlled firms minority shareholders heavily rely on the board of directors to mitigate blockholder expropriation, where board effectiveness is reflected in its level of independence.

Secondly, dividend is considered as a mechanism that reduces the free cash flow available for expropriation (Jensen & Meckling, 1976; Jensen, 1986). Paying out by the firm in the form of dividends reduces the cash available for managerial or blockholder discretion (Faccio, Lang, & Young, 2001; Jensen, 1986; La Porta, Lopez-de-silanes, Shleifer, & Vishny, 2000; Setia-Atmaja et al., 2009). Moreover, dividend payment is a financial commitment that places the management under external scrutiny when needing to raise external funding (Shleifer & Vishny, 1997; Easterbrook, 1984).

Thirdly, improving audit quality, externally in the form of appointing a Big Four auditor, and internally by improving the level of expertise and independence of the audit committee, decreases the ability of the blockholder to extract private benefits of control due to the increased level of monitoring (Fan & Wong, 2005). Large audit firms, normally represented by the globally renown 'Big Four' (KPMG, Ernst & Young, PricewaterhouseCoopers and Deloitte), have high level of expertise and are arguably more concerned about their reputation, therefore, making them more inclined to provide quality auditing services and detect any material misrepresentation in the financial reports (Khan et al., 2015; Fan & Wong, 2005; Lin & Liu, 2009).

As such, the board of directors, dividends and the audit quality can all be considered as mechanisms to control for both P-A and P-P agency problems (Setia-Atmaja et al., 2009). Given the central role of the board, dividend and the audit quality in the protection of minority shareholders, this study will investigate the respective role of these governance mechanisms under the presence of different types of blockholders in the context of Saudi public listed companies.

1.2 Research Context and Motivation

Saudi Arabia will be the focus country of this study. There are several motivations behind choosing Saudi Arabia. Saudi Arabia is an emerging/developing country that plays an important role in the global economy. It is the largest producer of crude oil and has the largest proven oil reserves in the world (CIA, 2014). Additionally, Saudi Arabia showed high

economic and political stability in a time of global economic crises and regional turmoil such as the credit crunch and the Arab Spring (Viñals & Ahmed, 2012; Jones, 2013).

Moreover, Saudi Arabia presents a unique setting, where religious, cultural and social factors, that are similar to those of other Arab and Islamic nations, play an important role in the day to day lives of the society. Islam is the only legal religion in Saudi Arabia, and Islamic law, referred to as *Sharia*, serves as its constitution (CIA, 2014). This context varies considerably from other studies on ownership structure and governance mechanisms in the literature, and therefore should offer additional insights.

The Saudi stock market, Tadawul, is the largest and most liquid in the Middle East and North Africa region (Tadawul, 2014; Koldertsova, 2010). Tadawul holds 167 firms from 15 sectors with a total market capitalization of over 500 Billion USD as of October 2014 (ZAWYA, 2014). Furthermore, the Saudi Capital Market Authority announced its plans to open the stock market for foreign investors in 2015 (CMA, 2014). As new foreign investors gain access to the market, it is important for them to understand the dynamics and key players of the market, and how the Saudi context may differ from other contexts that might be in their investment portfolios.

Blockholders are widely present in the Saudi stock market, where government and family blockholders control more than two thirds of the companies listed in Tadawul (Di Benedetto & Berg, 2009; Quttainah & Paczkowski, 2012). It is therefore expected that blockholders play an important role in the Saudi market,

which offers a unique opportunity to study blockholder influence on the governance of public listed companies. However, little is known about the corporate governance system in Saudi Arabia, as the area have attracted much less interest than Anglo-Saxon, European or East-Asian settings (Pierce, 2012; Kumar & Zattoni, 2014). Furthermore, Aguilera and Crespi-Cladera (2016, p.5) contend that “[t]he interaction between large shareholder and firms characteristics is a key element to understand the actual configuration of corporate governance where ownership structures are concentrated.”

1.3 Thesis Aims, Objectives and Research Questions

From the preceding discussion, it is clear that understanding the dynamics under which the Saudi capital market operates is an area worthy of investigation, where blockholders play a significant role given their wide presence. The objective of the thesis is to understand the role blockholders play in the governance of Saudi public listed companies, and to what degree are minority shareholders prone to expropriation. In doing so, this thesis aims to answer the question of: ‘Do blockholders influence the governance of Saudi public listed corporations?’

In answering the research question, this thesis will present three empirical chapters (chapters 3, 4 and 5) on the relationship of blockholders with three key governance mechanisms; namely the board of directors (chapter 3), dividend policy (chapter 4) and audit quality (chapter 5).

Each study will focus on the governance mechanism in question on minority shareholder protection under blockholder control. The objective is to study the influence of different types of blockholders present in the Saudi capital market on these governance mechanisms in order to uncover the level of threat each type might cause to minority shareholders.

Accordingly, the three empirical studies aim to answer these sub questions:

1st Study (Chapter 3 – Blockholders and the Structure of the Board):

What is the influence of blockholders on the composition of the board in Saudi Arabia?

- a. Do blockholders influence the independence of the board?

2nd Study (Chapter 4 – Blockholders and Dividend Policy):

What is the influence of blockholders on dividend payout in Saudi Arabia?

- b. Do blockholders influence the decision to payout dividends?
- c. Do blockholders influence dividend payout levels?

3rd Study (Chapter 5 – Blockholders and Audit Quality):

What is the influence of blockholders on audit quality in Saudi Arabia?

- d. Do blockholders influence the decision to assign a big 4 auditor?
- e. Do blockholders influence the level of expertise and independence of the audit committee?

1.4 Research Philosophy

It is vital to determine and justify the research philosophy employed when conducting social science research. Research philosophy is related to the development of knowledge and the nature of that knowledge (Saunders et al., 2008). Research philosophy mainly concerns the assumptions regarding the nature of reality, i.e. ontological, the researcher's relationship with what is researched, i.e. epistemological, and the research process being employed, i.e. methodological (Saunders et al., 2012; Collis & Hussey, 2009).

The research questions of the study should motivate which research philosophy to be employed (Saunders et al., 2012; Collis & Hussey, 2009). Therefore, determining the research philosophy is important as it helps in choosing the appropriate research tools to analyze the phenomena under investigation. This thesis is concerned with blockholders and minority shareholders' expropriation concerns in Saudi public listed companies. Specifically, the thesis examines the influence of blockholders on the governance of the firm through three key governance mechanisms, the board, dividends and audit quality.

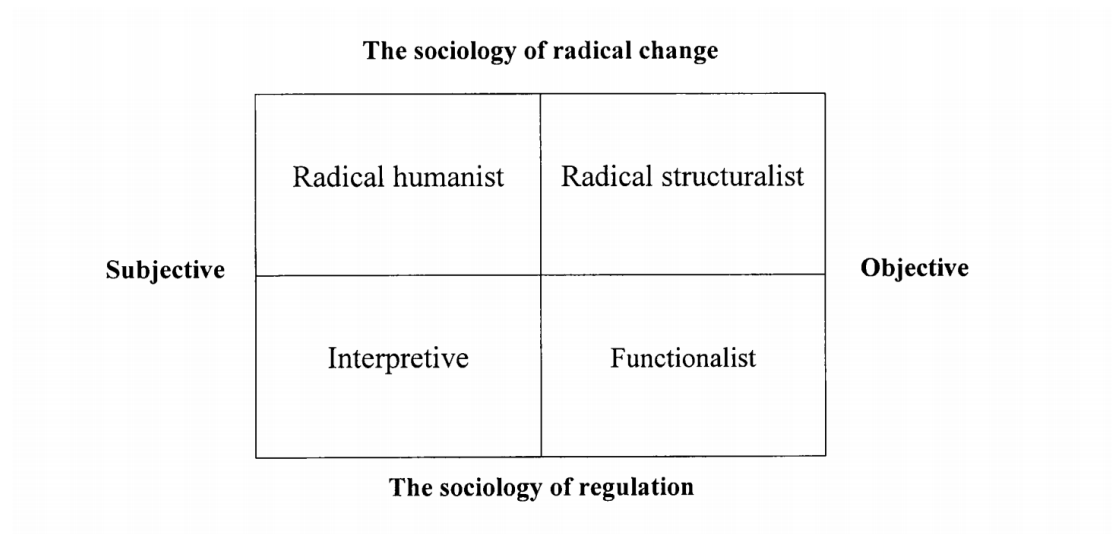
The two main research philosophical standpoints are positivism and interpretivism (Saunders et al., 2008). Positivism is an objectivist view of reality, where the researcher is independent from what is being studied, and mainly follows a deductive approach of hypothesis testing in the form of quantitative analyses of large data samples. On the other hand, interpretivism holds a subjectivist view of reality, where social phenomena is created from the actions

and perceptions of the different social actors, including the researcher, and is in a continuous state of revision through the process of social interaction. Interpretivism research mostly follows an inductive process of theory building through focused qualitative enquiry from a relatively small sample (Saunders et al., 2008).

Burrell and Morgan (1979) identify four paradigms for the analysis of theory in social science as shown in Figure 1.1, namely radical humanist, radical structuralist, interpretive and functionalist. The radical change paradigms, radical humanist and radical structuralist, are concerned with challenging and seeking to change the status quo (Saunders et al., 2012; Burrell & Morgan, 1979). The current research aims to study the influence of blockholders on the governance of Saudi public listed companies and their relationship with minority shareholders in order to understand and rationally explain the structural reality, not seek to change it. Therefore, both radical change paradigms are not suitable for such research.

The regulatory approach paradigms seek to explain social order either subjectively, through interpretivist, or objectively, through functionalist theory building, and thus are more suitable for the current research. The functionalist paradigm is the most applied approach in organizational and management research, which is problem oriented in nature and seeks to provide practical solutions to practical problems, while the interpretivist paradigm seek to make sense of the world, understand organizational affairs and discover irrationalities (Gioia & Pitre, 1990; Saunders et al., 2008).

Figure 1.1 Four Paradigms for the Analysis of Social Theory



Source: (Burrell & Morgan, 1979, p.22)

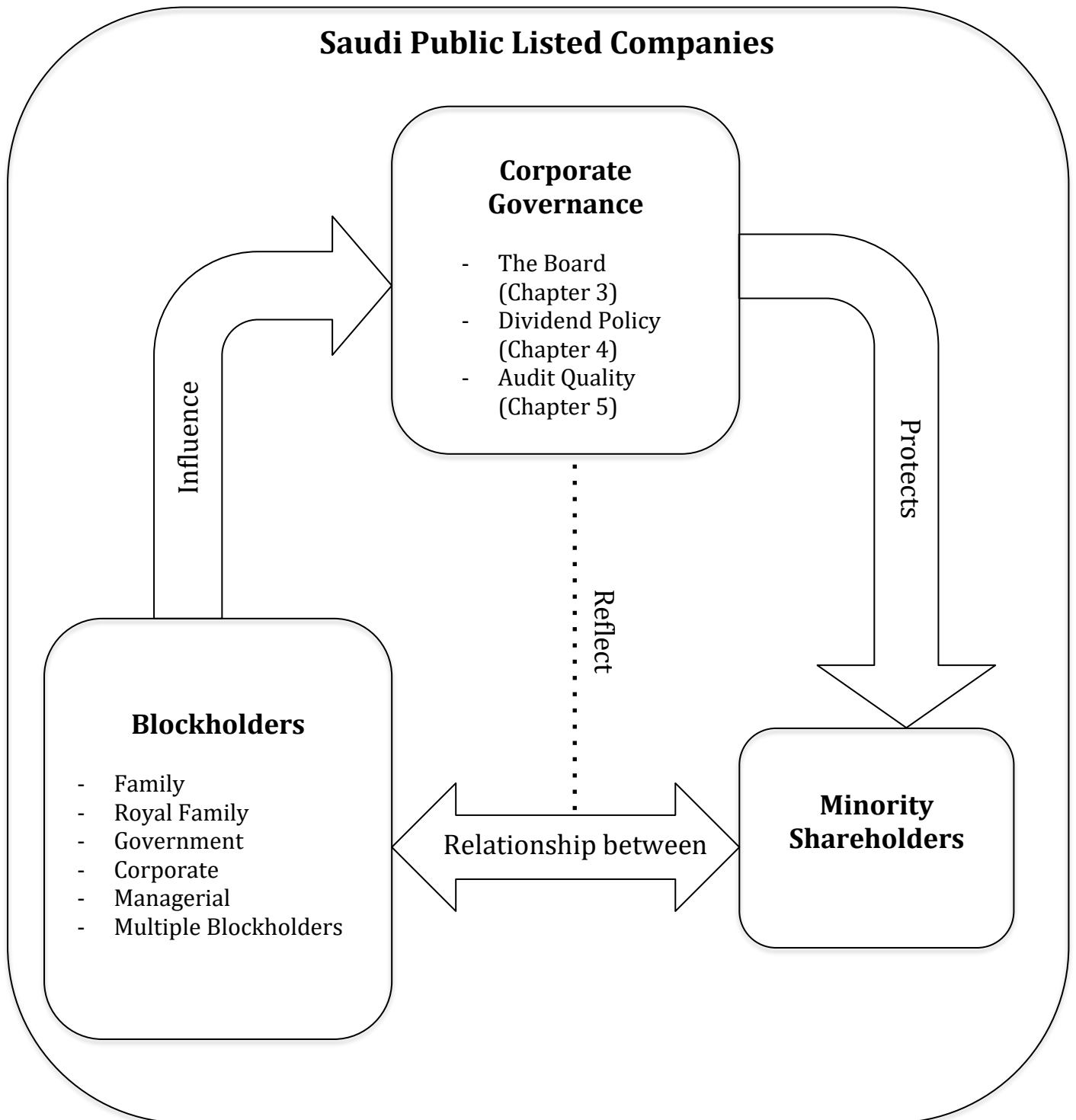
Scholars have argued against the black and white nature of the four research paradigms reported by Burrell and Morgan when conducting social science research (1979) (Gioia & Pitre, 1990). They assert that it is difficult to identify the boundaries of each research paradigm and that grey areas fall between the different paradigms, transition zones, are necessary for achieving a comprehensive view, which calls for the use of a pluralistic multiparadigm approach (Gioia & Pitre, 1990).

Utilizing a multiparadigm approach offers researchers the opportunity of creating insights that encompasses different ontological and epistemological assumptions, which taps different aspects of organizational phenomena that leads to producing theoretical views that are unique, different and informative (Gioia & Pitre, 1990). This thesis undertakes a multiparadigm approach, the transitional zone that links interpretivist and functionalist paradigms.

Saudi Arabian culture is characterized by high power distance and strong level of secrecy in corporate dealings, where sensitive information, such as expropriation and blockholder influence, is difficult to discuss with related parties (Ali, 2009; Cassell & Blake, 2012; Piesse et al., 2011). Consequently, conducting an interpretivist approach in order to collect the data becomes difficult through qualitative inquiry, especially for such a sensitive topic. Therefore, a positivism standpoint seems to be more appropriate in order to study the aforementioned phenomena. However, an interpretive approach is necessary for analyzing the results and benefit from the broad theoretical framework presented in each empirical chapter. Given the possible influence of institutional factors unique to the under investigated setting of Saudi Arabia, it is important for the researcher to take an interpretivist stance when analyzing the findings.

This thesis will employ a multiparadigm approach from the interpretivist-functional transition zone and employs panel data econometric regression models from manually collected secondary data of the different ownership structures, governance mechanisms and control variables in question. Accordingly, the researcher remains independent from social actors and is able to build causality, test hypotheses regarding the phenomena, and further develop the theories behind blockholder influence on the governance of Saudi public listed companies. Further details on the regression models used and data types will be discussed in each empirical chapter. Figure 1.2 shows the overall conceptual framework of the thesis.

Figure 1.2 Overall Thesis Conceptual Framework



1.5 Contribution to Knowledge

The thesis contributes to the literature in several ways. This thesis contributes to the P-P relationship and the private benefits of control associated with large shareholders by investigating the influence of blockholders on the governance of PLCs in a newly investigated setting, namely Saudi Arabia (Faccio et al., 2001; Renders & Gaeremynck, 2012; Young et al., 2008).

Furthermore, this thesis contributes to the literature on the role of multiple blockholders in corporate governance, by examining their relationship with key governance mechanisms (Maury & Pajuste, 2005; Attig et al., 2008; Attig et al., 2009; Edmans & Manso, 2009).

Moreover, this thesis contributes to the political connections literature by analyzing the governance influence of blockholders from the Saudi Royal family, who possess financial, legal and social advantages over other types of owners in the country (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2014; Faccio, 2010; Fan, Wong, & Zhang, 2007; Khwaja & Mian, 2005).

Finally, this thesis contributes to the Islamic business ethics literature by developing a conceptual framework based on evidence from a predominant Islamic country on the relationship between controlling blockholders, corporate governance and minority shareholders. Namely, the thesis examines the influence of institutional factors, namely the Arabian culture and Islamic religion, in shaping the behavior of blockholders towards minority shareholders and the governance of the firm.

1.6 Thesis Structure

The thesis constitutes three studies on the role of blockholders in the governance of Saudi firms. Each study is represented in a stand alone empirical chapter that will include a literature review, methodology and results section. The next chapter will provide an overview of Saudi Arabia. Chapter three will present the first study, which analyses the blockholder and board structure relationship. Subsequently, chapter four will present the blockholder and dividend relationship, which serves as the second study. And the third and final study, which analyses the blockholder and audit quality relationship, will be presented in chapter five. Finally, a summary of the results from the three studies, as well as suggestions for future research will be offered.

Chapter Two

Overview of Saudi Arabia

2.1 Introduction

This chapter will provide a background to the country that serves as the context of the study, namely the Kingdom of Saudi Arabia. After highlighting the motivations behind choosing Saudi Arabia in the preceding chapter, this chapter will reflect on the historical, political and economical factors that shape the country in order to set the scene for the empirical investigation in the subsequent chapters.

2.2 Background to Saudi Arabia

2.2.1 Brief History

The Kingdom of Saudi Arabia, or generally referred to as simply Saudi Arabia, is a monarchy state that lies on the Arabian Peninsula in the Middle East at the heart of the Arab Islamic world. The establishment of modern Saudi Arabia took place in the early 20th century. In 1932, King *Abdulaziz Ibn Saud* united numerous tribal territorial rulings, along with the emirates of *Hijaz* [the western part of the peninsula] and *Ha'il* [the northern part of the peninsula], and claimed Riyadh [a city in the central part of the peninsula] as the capital of the new state. This unity was achieved after a series of efforts led by the *Ibn Saud* family and their religious partners which spanned for more than a century (Wynbrandt, 2010; Bowen, 2008).

Initiating from *Najd* [the central part of the Peninsula] in the 18th century, *Mohammad Ibn Saud* and his religious partner, *Muhammad Ibn Abd Al-Wahhab*, joined forces to bring *Najd* and the rest of Arabia, who they believed have departed from the original Islamic teachings, back to what they believed is the pure form of Islam under the doctrine of *tawhid* [oneness of God] (Al-Rasheed, 2010; Wynbrandt, 2010).

This Saudi-Wahhabi movement [called after the surname of the founders] led to the establishment, and latter fall, of two Saudi states, the Emirate of *Diriyah* [1744-1818] and the Emirate of *Najd* [1824-1891]. This paved the way for the foundation of the third, and current, Kingdom of Saudi Arabia under the banner of religious legitimization led by King *Abdulaziz* and his Islamic religious group the *Ikhwan* [brotherhood] (Al-Rasheed, 2010).

The main message of the founders was to spread Islam in the form of *da'wa* [call] and unite the Arabs under the enforcement of Islamic *sharia* [rulings] through gaining allegiance from tribal leaders and their followers (Al-Rasheed, 2010). This strategy proved to be vital for their success in a region that marks the birth of Islam and hosts its two Holy Mosques of Mecca and Medina, in addition to the important role that tribal loyalty and kinship plays in the lives of Arabs in general (Bowen, 2008; Long & Maisel, 2010).

2.2.2 Geography and Demographics

Located in the Middle East, Saudi Arabia occupies more than 80% of the Arabian Peninsula, and is comprised of mostly desert terrain. As figure 2.1 shows, Saudi Arabia abuts two long coastlines: the Red Sea to the west, and the

Persian Gulf to the east, and shares borders with eight Arab and Islamic countries: Yemen, Oman, United Arab Emirates, Qatar, Bahrain [offshore], Kuwait, Iraq, and Jordan.

With the predominant dessert terrain of the country, water shortage is one of the main resource problems that faces Saudi Arabia (Long & Maisel, 2010). However, in the last two decades, the Saudi government has invested billions of dollars in one of the largest sea water desalinization systems in the world (Bowen, 2008).

Saudi Arabia is the largest country of the Gulf Cooperative Council [GCC] in terms of size, population and economy [measured by GDP]. The GCC was established for the purpose of promoting regional cooperation and common defense for conserving the monarchies of its member states (Bowen, 2008). The GCC constitutes six Arab states, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. These countries share a lot of similarities in terms of culture, religion, economy amongst other factors (Pierce, 2012).

Arabic is the only official language, and Islam is the only legal religion in Saudi Arabia. The entire Saudi population are Muslims, of which 90% are *Sunni* Muslims² and the remaining 10% are *Shia* Muslims³ (Bowen, 2008). The major ethnic group is Arabs, which comprises more than 90% of Saudis (Long & Maisel,

² The Wahhabi teachings are a strict form of Sunni

³ Shia are generally concentrated in the eastern region along the Persian Gulf

2010). The total population is estimated to be around 27 million, where non-Saudi immigrants make up more than 30% of that figure (Pierce, 2012).



Figure 2.1 The Map of Saudi Arabia. Accessed 1 May, 2014. Available at: 'http://www.britannica.com/media/full/62085'

2.3 Economy

2.3.1 Oil Based Economy

It can be argued that the most significant event in the history of Saudi Arabia was the discovery of oil. Prior to the discovery of oil in Saudi Arabia, the main source of income for the government was the moderate revenues from pilgrimage visitors to the two Holy Mosques and limited agricultural resources (Long & Maisel, 2010).

Soon after the establishment of the state in the 1930s, and after the success of the British in oil production in the region⁴, the Saudi government granted an American company, Standard Oil of California (SoCal, currently Chevron) concessions for oil exploration in 1933 (Long & Maisel, 2010). The concessions turned to immediate success, as oil was discovered in great quantities in the eastern region of Saudi Arabia and by 1939 SoCal was producing over half a million barrels a year (Bowen, 2008).

To this day, oil remains the most important resource for Saudi Arabia, as it accounts for more than 90% of its exports and around 80% of the government revenues (Pierce, 2012). Holding the largest proven oil reserves in the world, Saudi Arabia has grown to be one of the largest producers of crude oil (CIA, 2014).

⁴ The British had already established the Anglo-Persian Oil Company, and had agreements to gain oil concessions in several gulf states, such as Kuwait, Bahrain and Iraq (Bowen, 2008).

Huge revenues from oil production over the past four decades helped the country to develop and build vast infrastructure projects, invest in healthcare and education, and raise the living standards of its citizens in general. Currently Saudi Arabia is ranked 20 from 230 countries in terms of GDP per capita (CIA, 2014).

Given the country's high reliance on oil revenues, the government took action to diversify the economy over the past two decades, which is reflected in the mass privatization program of various previously fully government owned entities, such as the electricity, water, telecommunication and airline industries, as well as its development of the private sector and capital market by issuing laws and regulations that increased the confidence of investors and the general public (Fallatah & Dickins, 2012). Furthermore, huge government spending in various projects, which is fueled by high oil revenues, facilitated the growth of the private sector and the economy in general.

2.3.2 Saudi Vision 2030

Recently, the government of Saudi Arabia initiated an economical and social program called 'Vision 2030' which established strategies that aim to diversify government's reliance on oil revenues. The initiative embraced the development of various sectors, including healthcare, education and the overall economy amongst others, in its strategies (KSA, 2016).

The vision will introduce structural reforms that will develop and empower the private sector by increasing its transparency and efficiency. The vision also outlined the plan of a 5% part-privatization of the national oil company,

ARAMCO, in order to create the world's largest energy conglomerate and to be partly listed on the Saudi Stock Exchange TADAWUL, by as early as 2017 (KSA, 2016).

Furthermore, the vision set clear targets and benchmarks for the country to achieve by the year 2030. These include, but are not limited to, increasing the foreign direct investment from 3.8% to 5.7% of the GDP, increasing the private sector's contribution from 40% to 65% of the GDP, increasing the Public Investment Fund's assets, which is the country's sovereign wealth fund, from 600 billion Saudi Riyals (the equivalent of 160 billion US Dollars as of December 2016) to more than 7 trillion Riyals (the equivalent of 1.86 trillion US Dollars as of December 2016) making it the largest sovereign wealth fund in the world, and advancing to be amongst the top 10 countries on the Global Competitive Index and top 15 largest economies in the world from the current 25th and 19th position, respectively (KSA, 2016).

This vision might be vital for sustaining a prosperous future for the country, especially when regional turmoil and instability in bordering countries exhausted the government budget, which heavily relied on depleting oil revenues due to the huge drop in oil prices in recent years. Diversification of government income streams, encouraging foreign investments as well as developing the private sector and secondary markets will aid in solidifying the Saudi economy in facing any future challenges.

2.4 Saudi Stock Market - TADAWUL

The Saudi capital market, officially known as TADAWUL or TASI all share index, is a relatively new stock market. The first public listed company in Saudi Arabia initiated in the early 1930's, and the number of companies reached 14 by the late 1970's, however, the market remained informal until 1984, when the government formed the Saudi Arabian Monetary Agency [SAMA] which was assigned the task of developing, regulating and monitoring the capital market (Tadawul, 2014). Yet, it was not until 2003, with the issuance of the Capital Market Authority [CMA] which is responsible for regulating and supervising the capital market, did the market witness significant development, in terms of increased number of listed firms, advanced market regulations and rigorous reporting and disclosure requirements (Al-Nodel & Hussainey, 2010).

By the year 2005, the Saudi stock market Tadawul had 81 listed companies, since then, the number of listed companies increased by more than one fold to reach 171 companies from 15 different sectors by the end of 2015 (Bloomberg, 2015). Tadawul, is the largest and most liquid stock market in the Middle East and North Africa region (Tadawul, 2014; Koldertsova, 2010). Tadawul had a market capitalization of over 500 billion US Dollars as of October 2014 (ZAWYA, 2014).

Blockholders are widely present in the Saudi stock market; where government and family blockholders control more than two thirds of the companies listed in Tadawul (Di Benedetta & Berg, 2009; Quttainah & Paczkowski, 2012; Solomon, 2010; Al-Bassam et al., 2018). Family businesses that went public as well as

partially privatized government entities represent the majority of listed firms (Abdullah et al., 2014; Lessambo, 2014). Details on the concentration and distribution of different blockholder types present in the Saudi capital market will be presented in the empirical studies in chapters 3, 4 and 5.

The stock market in Saudi Arabia plays an important role in the economy and is accessed by many of its population. In their study on share ownership around the world, Grout et al. (2009) found that the country with the highest percentage of population for individuals investing in publicly listed shares, from a sample of 54 countries, was Saudi Arabia. Grout et al. (2009) reported that 38.2% of the Saudi population invested in shares of publicly listed companies, compared with 12.6%, 15.09%, 0.14% and 5.02% for the U.S., U.K., Russia and Iran respectively. In terms of actual figures, the number of individuals investing in public listed shares in Saudi Arabia reported in their study was 10,743,440. Only the U.S., Japan and China had a higher number of investing individuals in publicly listed shares (Grout et al., 2009). These figures reflect the importance of the stock market to the general public.

The Saudi stock market experienced a massive bull market since the beginning of the millennium, which attracted many new investors from the general public in to the market. However, in 2006, a huge collapse occurred to the entire stock market and share prices dropped dramatically, and by December 2006 Tadawul had lost around 53% of its market capitalization, or the equivalent of 480 billion US Dollar (Alamri, 2014; Fallatah & Dickins, 2012; Al-Nodel & Hussainey, 2010). It is argued that the market was over inflated and a correction to the bubble was

inevitable, however, the majority of investors, who are unsophisticated individuals, were unaware of such situation and any accompanying consequences (Yang, 2007).

This huge collapse dramatically affected the confidence in the stock market and shocked investors, of whom mostly were middle class citizens (Yang, 2007). This led the CMA to issue a new code, the Corporate Governance Regulations (CGR), immediately in order to regain the confidence of the general public in the stock market and better govern the listed firms (CMA, 2010). The corporate governance code and other regulations of the capital market will be discussed in more detail in section 2.5.2.

2.5 Regulatory Framework

2.5.1 Islamic Law and Sharia

Saudi Arabia has been heavily influenced by Islam, it holds the place of the religions' birth as well as the two Holy Mosques of *Mecca* and *Medina*. Thus Saudi Arabia is regarded as the custodian of Islam in the eyes of the Muslim population, and it has acted in that manner ever since its establishment under *Ibn Saud* and his religious partner *Muhammad Ibn Abd Al-Wahhab* (Almajid, 2008; Falgi, 2009).

Therefore, in establishing the country, King *Abdulaziz Ibn Saud*, the founder of the Kingdom, has based the legislative system of the country on Islamic Law (*Sharia*). Unlike other Arab and Islamic nations, Saudi Arabia has no constitution;

Sharia instead serves as its constitution (Al-Fahad, 2005). *Sharia* consists of the Islamic Holy Book, The *Quran*, the teachings of Prophet *Mohammed* PBUH, *Sunnah*, and the interpretations and reasoning of religious scholars, *Ijmaa'* (Di Benedetto & Berg, 2009; Almajid, 2008).

While *Sharia* serves as the constitution of Saudi Arabia, detailed rulings and regulations pertaining different areas, such as administrative and commercial law for example, are issued through royal decrees (Al-Fahad, 2005). The role of Islam will be discussed in section 2.6.1, while the following section will elaborate on the regulations regarding the Saudi capital market.

2.5.2 Capital Market Regulation

As noted, the primary source of law in Saudi Arabia is the Islamic Law, *Sharia*. Regulations, however, are often issued by royal decrees, and are elaborations of *Sharia*, which provide more specific requirements and guidance on commercial relations. The legal framework governing companies in Saudi Arabia are the Companies Law [CL] and the Capital Market Law [CML], while the Capital Market Authority [CMA] is the main regulator of the Saudi capital market (Almajid, 2008; Di Benedetto & Berg, 2009).

The Companies Law, issued in 1965, is considered the first planned effort to regulate the operations of companies in Saudi Arabia. The law also introduced shareholder rights for the first time, such as the general assembly and voting rights (Di Benedetto & Berg, 2009; Falgi, 2009). In 2003, following the collapse of multinational corporations such as Enron and WorldCom, the Saudi government issued a royal decree that introduced the Capital Market Law [CML], and

established the Capital Market Authority [CMA] with the objective of regulating the functioning of the capital market.

The CMA possesses financial, legal and administrative independence, from any other governmental authority, in decision making (Alsanosi, 2010; Almajid, 2008). The CMA is supposed to protect the interests of the investing public by controlling and developing the capital market through the formulation and implementation of appropriate rules and regulations (Alsanosi, 2010; Almajid, 2008). In order to restore investors' trust in the stock market, following a major correction to the entire stock market in 2006, the CMA issued its first Corporate Governance Regulations [CGR] (Ramady, 2007).

The CGR code follows a 'comply or explain' approach similar to that of the Combined Code of the U.K., and includes various recommendations covering shareholder rights, disclosure and transparency, internal control and risk management, and the board of directors. A second version of the CGR was later issued in 2010, which made several parts of the previous code mandatory⁵ (CMA, 2010). Listed firms are required to issue an annual report of the board of directors that includes all the governance related recommendations of the CGR the company complies with or the reason behind non-compliance. The report also discloses information regarding board and executive remuneration as well as blockholder ownership.

⁵ A copy of the 2010 Saudi CGR is attached in Appendix A

The code in general is similar to the U.K. Cadbury Report of 1992, thus is largely based on an Anglo-American governance model, such as the OECD principles of corporate governance (Almajid, 2008; Falgi, 2009; Pierce, 2012; Al-Bassam et al., 2018; Bahrawe et al., 2016). The introduction of the code was a major step in increasing the amount of information disclosed to the general public, which helped reduce the information asymmetry that existed between corporate insiders and outside shareholders.

However, more effort needs to be taken to improve the governance of Saudi Arabia. The new efforts need to take into consideration the unique cultural and institutional aspects of the country, especially in light of two recent accounting scandals that hit the stock market, namely Al-Mojil Group, and Mobily (Rashad & Al Sayegh, 2015; Al Omran, 2016).

Al-Mojil Group, a large constructions contracting listed firm, had its shares suspended from trading since 22/07/2012 after accumulating huge losses. Furthermore, Al-Mojil board of directors was recently accused of manipulation and fraud in the initial public offering of their shares by the Saudi stock market regulator in 18/06/2016 after an extended investigation. Three of its board members, including the founder, were sentenced to jail, for terms ranging from three to five years, and the company was fined 1.6 Billion Saudi Riyals, the equivalent of 427 million US Dollars. However the case is not yet settled as the defendants have appealed against these allegations (Torchia, 2016; Al Omran, 2016; CMA, 2016; CMA, 2012).

Al-Mojil Group's inflated IPO figures and manipulated accounts drew many investors into the family controlled firm in 2008, who suffered accumulated losses afterwards, which led to the suspension of trading for more than four years. Accordingly, this might be a clear reflection of a case where controlling blockholders, namely the founding family, expropriated minority shareholders through their ultimate control over the firm.

Mobily, or formally known as Etihad Etisalat Co., is the second largest telecommunications company in Saudi Arabia. The firm grew significantly since it started operations in 2005 by ending the monopoly enjoyed by the government owned Saudi Telecommunication Company. In 2014, the firm misreported profits of 220 million Saudi Riyals (the equivalent of 58.6 million US Dollars), and later announced that they had actually incurred losses of 913 million Saudi Riyals (the equivalent of 243.4 million US Dollars) (Mathew & Khan, 2015).

The misreporting caused the Saudi Capital Market Authority to suspend trading of the firm's shares from 25/02/2015 to 05/03/2015 and later from 09/06/2015 to 03/08/2015, in order for the CMA to conduct an investigation behind the causes of the misreporting and for the firm to reissue a restated consolidated financial statements for the year 2014 and the first quarter of 2015 (CMA, 2015b; CMA, 2015a; CMA, 2015c). Mobily has since complied with the CMA requirements and has also removed its CEO, *Al Kaf* who was the company's first CEO, from his position after a detailed internal investigation lead by the

board to find the possible causes behind the misreporting (Mathew & Khan, 2015; Rashad & Al Sayegh, 2015).

Both cases reflect the importance of rigorous regulations and market oversight that limits the manipulation capacity of controlling insiders, by both blockholders and entrenched managers, as well as the importance of the external auditors in detecting any misreports and manipulation of accounts, in order to protect minority shareholders from expropriation and to hold the related parties accountable.

Moreover, the regulations and efforts by the Saudi government need to take into account the unique institutional arrangements of the country in order to better tackle the governance issues and overcome any inadequacies that might arise from pure copying of Western developed corporate governance recommendations.

The next section will present a discussion identifying the principal in the Saudi publicly listed sector, with an aim to reflect on the key decision makers and primary owners of public listed firms in Saudi Arabia. Identifying the principal will help better understand the Saudi context and acknowledge any possible concerns between the different stakeholders in question.

2.6 Corporate Governance in Saudi Arabia

This section investigates corporate governance in the context of Saudi public listed companies. In order to study the corporate governance system in a particular context, it is important to identify the main principals in question, as in a typical principal-agent relationship. In the Anglo-American governance model, for example, the key principals are the shareholders, or capital providers, whereas the Continental European system, such as that found in Germany, gives more emphasis on a wider group of stakeholders, such as employees, banks, trade unions, and suppliers (Piesse et al., 2011; Hasan, 2009; Kasri, 2009; Lewis, 2005).

In identifying the main principal in the Saudi Arabian context, it is important to investigate the different factors that might have affected the development of the principal in the first place, and then examine the principals in practice. The three factors that will be studied are the influence of the Islamic religion, the legal system and the actual practices.

2.6.1 Corporate Governance and Islamic Sharia

Islam or *Sharia*, as a religion and legislation, is a way of life, in the sense that it does not only cover religious rituals and acts of worship, called *Ibadat*, but also structures transactions, relationships, dealings and acts of people with each other and with their environment, called *Muamalat* (Abu-Tapanjeh, 2009; Falgi, 2009; Febianto, 2011; Cheffins, 2008).

From the Islamic perspective, ownership rights originate from the concept of stewardship, *Khilafah*, as The *Quran* and *Sunnah* clearly assert that God, *Allah* The Almighty, is the sole, absolute and eternal, owner of property, all that is on the heavens and on earth, and man is the trustee and vicegerent of *Allah* (Abu-Tapanjeh, 2009; Hasan, 2009; Iqbal & Mirakhor, 2004; Lewis, 2001). Furthermore, accountability is also a central aspect in Islam, as all humans will be held accountable for their deeds in the day of judgment (Lewis, 2001; Beekun & Badawi, 2005; Rizk, 2008a).

Property rights in Islam are expected to present a comprehensive framework that identifies and protects the interests and rights of every individual, organization, community, and the state (Iqbal & Mirakhor, 2004; Hasan, 2009). Though the individual's possession of resources and his share in the outcome is approved and protected by *Sharia*, these rights are limited as not to conflict with the interest and well being of the society. Any property acquired through breach of trust, corruption, fraud, or unethical means does not satisfy the definition of property, *al-mal*, and therefore its ownership is not considered to be legitimate according to *Sharia* (Iqbal & Mirakhor, 2004; Cheffins, 2008).

The *Sharia* legality of the form of a joint stock company, and its accompanied limited liability and separate legal status, has been a matter of debate from Islamic *Sharia* scholars (Hassan et al., 2012; Zuryati et al., 2009). Consequently, detailed laws on the protection of investor rights is generally absent in the body of Islamic literature, due to the relatively new existence of modern corporations and its associated controversy (Ahmed, 2012).

Therefore, Islamic law scholars need to clearly establish a stand on corporate personality and address in detail the various rights of shareholders in a corporate framework, such as that found in modern corporate law, in order to protect shareholders, creditors and other stakeholders from the possibility of appropriation by insiders (Ahmed, 2012; Zuryati et al., 2009). However, the existence of appropriate corporate governance measures, which are mostly developed in Western countries that do not contradict Islamic teachings, can also help in the protection of stakeholder interests in Saudi Arabia and other Islamic countries where the establishment of a corporation with separate legal status is permitted and protected by law (Chapra & Ahmed, 2002).

Lewis (2005) summarizes three major underlying principles that differentiates the Islamic corporate governance system from its Western counterpart. Firstly, the Western concept of corporate governance is derived from a 'secular humanistic' perspective rather than being based on a religious moral authority, which is represented in the Islamic model under the concept of *Tawhid*, meaning the oneness of *Allah*, to whom is the destiny of all. *Tawhid* directs the relationships between humans as well as with their environment, obliges mankind to follow the guidance of *Sharia* in all aspects of life and prohibits any wrongdoings and shameful acts (Choudhury & Hoque, 2006; Hasan, 2009; Abdul Rahman, 1998). Accordingly, all Muslims should work towards this life and the Hereafter by adhering to the teachings of *Islam*, in order to gain blessings and avoid punishment (Chapra & Ahmed, 2002; Arsad et al., 2015; Rizk, 2008b).

Secondly, the Western corporate culture is rooted in a self-interest paradigm with no overarching requirement to take account of the wider interests of society. Islam, however, makes huge emphasis on the accountability of the individual towards the community at large (*Ummah*), as well as the environment, where Muslims ought to be fair, honest and just toward others, and should not be motivated by greed or selfishness (Rizk, 2008b; Ali et al., 2017; Al Kahtani, 2014). For example, the economic principle of *Zakah*, the special alms levy, or mandatory charity, paid to the deprived and people in need, reflects the consideration for different stakeholder groups the firm and individual should encompass (Choudhury & Hoque, 2006; Hasan, 2009; Lewis, 2005; Abdul Rahman, 1998).

Thirdly, the model of Western corporate governance is based mainly on agency theory rather than stewardship theory, and therefore views mankind as a self-interested opportunistic agent who needs to be monitored and controlled. Conversely, in the Islamic view, all people are entrusted to act in the interest of the greater good. Under Islam, all humans are regarded as custodians, vicegerents, of *Allah*, and are entrusted to use all available resources efficiently and equitably for the benefit of the entire community, or *Ummah*, with the objective of sustaining, maintaining and preserving every existing thing (Iqbal & Lewis, 2009; Abdul Rahman, 1998; Rizk, 2014; Al Kahtani, 2014).

Based on these considerations, it is argued that the principles of property rights and contracts under Islam offer a theoretical foundation that acknowledge the rights of all stakeholders (Iqbal & Mirakhor, 2004; Cheffins, 2008), where

business dealings ought to be conducted in accordance with *Sharia*, as being fair, just and honest toward others (Rizk, 2008b; Al Kahtani, 2014). Likewise, Beekun and Badawi (2005, p.143) state that

“The Islamic ethical system is balanced, fair, just, and benevolent, and seeks to respect the rights of both primary and derivative stakeholders without allowing for exploitation, nepotism and other human ills”.

This Islamic ethical system directly affects the behavioural norms of individuals who are expected to ultimately serve the best interest of the society (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015).

Another key Islamic concept is the institution of *Hisba*, an authority, individual or group, that ensures compliance with the requirements of *Sharia*, and the role of *Muhtasib*, who is delegated to promote virtue, all that is good, and discourage vice and all that is evil (Chapra & Ahmed, 2002; Lewis, 2005). In order to operationalize *Hisba*, several scholars advocated the introduction of a *Sharia* Supervisory Board (Lewis, 2001; Febianto, 2011; Safieddine, 2009; Hasan, 2009). The *Sharia* Board has been mainly advocated for Islamic financial institutions, which rather tend to be complex in the nature of their operations and require in-depth knowledge and investigation to identify acceptable, *Halal*, and unacceptable, *Haram*, transactions. This includes, amongst others, transactions that involve *Riba*, the prohibited interest or usury in financial dealings, which is an integral part of the global financial system (Safieddine, 2009).

Hasan (2009, p.277) concludes that the Islamic corporate governance model “combines the element of *Tawhid*, *Shura*, *Shari’ah* rules and maintains the private

goal without ignoring the duty of social welfare”. In this case the Islamic principle of *Shura*, consultation, in decision making, which takes into consideration the opinion and input of various stakeholders, both direct and indirect, represent a foundation for a stakeholder view of the firm. Any decision that affects others has to be taken by consensus, or *Shura*, under *Sharia* (Azid et al., 2007; Lewis, 2005). Accordingly, Hasan (2009; 2011) summarizes the differences between the major aspects of the Islamic corporate governance model and that of the Western; the Anglo-Saxon and the Continental European models, as follows in Table 2.1.

Table 2.1 The differences between Islamic and western concept of corporate governance

Aspects	The Anglo-Saxon Model	The European Model The	The Islamic Model ‘ <i>Sharia</i> ’
Episteme	Rationalism and rationality.	Rationalism and rationality.	Faith-based rationalism with <i>Tawhid</i> as a basis.
Rights and Interests	To protect the interests and rights of the shareholders.	The rights of the community in relation to the corporation.	To protect the interests and rights of all stakeholders subject to the rules of <i>Sharia</i> .
Corporate Goal	Shareholders controlling managers for purpose of shareholders’ profit.	Society controlling corporation for purpose of social welfare.	Acknowledge profit motive orientation but balance it with the <i>Sharia</i> objective and principles.
Nature of Management	Management dominated.	Controlling shareholder dominated.	Concept of vicegerency and <i>Shura</i> .
Management Boards	One-tier board.	Two-tier boards; executive and supervisory responsibility separate.	<i>Sharia</i> board as part of the governance structure.

Source: adopted from (Hasan, 2011; Hasan, 2009)

Ultimately, the *Sharia* governance model combines the elements of stewardship and legitimacy. Suchman (1995, p.574) defines legitimacy as

“[A] generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions.”

By advocating the principle of accountability and vicegerency, humans are seen as stewards who are supposed to act in the best interest of all (Azid et al., 2007; Rizk, 2008b). Additionally, by considering a wider group of stakeholders, direct and indirect, through involving them in the decision making process, via the *Shura* principle, as well as aiding the deprived, by the institution of *Zakah*, corporations become more inclined to legitimize their actions and existence towards the society at large under the *Sharia* governance model (Lewis, 2005).

Under the Islamic economic system, the performance of the firm is not measured by the classical single dimensional financial aspect, it is rather a multi dimensional view that emphasizes on ethical aspects such as promoting human welfare, preventing corruption and enhancing social and economic stability (Ali et al., 2017; Bedoui & Mansour, 2015). Azid et al. (2007, p.23) further contend that the responsibility of the management in the *Sharia* or Islamic system, is “to increase the general prosperity and service of the [entire] society’s well being”.

Ultimately, Islamic religion, or *Sharia*, assumes the principal to be a representation of various stakeholders, in which the main objective of the firm isn’t profit maximization, rather, continuity and societal welfare are the fundamental objectives of the Islamic ethical system that is expected to drive Islamic behavioral norms (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015).

2.6.2 Corporate Governance and Saudi Law

Saudi laws and regulations regarding public listed companies have been enacted to govern the relationship between the board of directors, managers and shareholders, in order to align the interests of directors and managers with that of the shareholders (Almajid, 2008). While the CGR, discussed earlier, do recognize the interest of stakeholders, as the aim of the code is to protect “shareholders rights as well as the rights of the stakeholders” (CMA, 2010, p.3), however, it does not set clear guidelines on how stakeholder rights are safeguarded nor the punishment to any breach of rights (Piesse et al., 2011).

The legal system in Saudi Arabia generally emphasizes the protection of shareholders in particular, through voting rights and the general assembly for example. It is, therefore, argued that the Saudi corporate governance model, similar to many developing countries, has been influenced by the Anglo-American ‘shareholder’ model, which focuses on maximizing shareholders’ wealth (Fallatah & Dickins, 2012; Piesse et al., 2011). Consequently, even though the code explicitly mentions the interest of stakeholders, it is more inclined towards protecting the rights of shareholders in particular as it lacks direct measures that represent other stakeholders’ interests, such as two tier board structures (Almajid, 2008; Fallatah & Dickins, 2012; Piesse et al., 2011).

Furthermore, while the Saudi corporate law allows shareholders to take derivative actions against the directors of the company in the case of wrongdoings, there is no separate law that contains specific rulings for minority shareholders in particular (Lessambo, 2014). Therefore, it can be argued that the

Saudi legal system follows the so called shareholder model that protects the interests of shareholders in general, in which maximizing shareholder return is the main objective of the firm (Fallatah & Dickins, 2012).

While the legal system in Saudi Arabia is *Sharia* based, in the corporate environment it fails to fully encompass the *Sharia*, or Islamic, governance model, where *Shura* in decision making for example, which takes into consideration the input from the various stakeholders, is the necessary management style (Piesse et al., 2011). The previously discussed *Sharia* governance model aims at maximizing the wellbeing of the entire society not solely shareholders. Hasan (2009, p.287) argues, that “It is observed however that the main objective of many corporations including the so called Islamic corporation is to maximize the shareholder’s value of wealth. This implies that in actual practice, many Islamic corporations adopt the shareholder model of corporate governance rather than the stakeholder model”.

Kasri (2009, p.1) argues that “Although Islam as a way of life has always promoted good ethics, strong morals, unshakeable integrity and honesty of the highest order, in practice it is not easy to incorporate such ethical values into an ‘Islamic’ corporate governance standard and then implement it”. Furthermore, Rizk (2008b, p.212) states that “Although it is not possible to locate societies where Islamic values, morals and ethical principles are truly implemented in every sphere of life, as described by the Qur’an and Sunna, this does not nullify the validity of the [Sharia] model itself”.

Ultimately, the Saudi legal system emphasizes on the protection of shareholders at large, who represent the chief principal in Saudi listed firms, without providing detailed measures and tools that help various stakeholders as well as minority shareholders to protect their interests and convey their voices (Almajid, 2008; Fallatah & Dickins, 2012; Piesse et al., 2011). This, however, does not reflect the Islamic ethical system that emphasizes on societal development and welfare, which is expected from a country that is heavily influenced by Islamic *Sharia*, which serves as its constitution (Ali et al., 2017; Bedoui & Mansour, 2015).

2.6.3 Corporate Governance in Practice

Corporate ownership in Saudi Arabia is highly concentrated, with a strong presence of two types of investors, the state and wealthy families (Al-Bassam et al., 2018; Alshehri, 2012; Piesse et al., 2011; Bukhari, 2014). Collectively, the government and founding families own more than 75% of the companies listed in the Saudi capital market (Lessambo, 2014).

The Saudi government normally maintain majority shares in petrochemical and utility companies, and their primary objective is control over these strategic sectors, as they tend to hold a majority stake that averages around 35% (Piesse et al., 2011). For example, the Saudi government owns 70% of SABIC (Saudi Basic Industries Corporation), which is a global petrochemical manufacturer and is the largest listed company in terms of market capitalization in the Middle-East, and 70% of Saudi Telecom (STC), which is the largest telephone service provider in the country (Tadawul, 2014). Ultimately, firms with majority government ownership in Saudi become under complete control of the government, who are

able to appoint board members and executive managers without being challenged by other shareholders (Almajid, 2008).

In the case of family ownership, two prevailing types can be found, wealthy families with strong links to the government, such as the members of royal family, along with founding families (Almajid, 2008; Solomon, 2010; Piesse et al., 2011). As the stock market in Saudi Arabia started to develop, several family run businesses went public to generate capital that covers their growth potential (Falgi, 2009; Lessambo, 2014). Many listed companies still hold the name of their founders, and the founding family still control key executive positions and heavily influence decision making (Almajid, 2008; Piesse et al., 2011). Wealthy families, on the other hand, are heavily invested individuals who control shares in many companies in the Saudi market (Almajid, 2008; Lessambo, 2014).

Along with Islamic religion that has been discussed previously, familial ties and kinship are the other dominant features of the Saudi culture (Long & Maisel, 2010; Bukhari, 2014). The genealogical tribal nature of the region and the emphasis on familial ties and relationships are embedded aspects in the daily life of Saudis (Haniffa & Hudaib, 2007; Bjerke & Al-Meer, 1993).

In many cases, familial ties and friendship are more important than qualifications and merits in decisions for job appointments, including senior level positions (Bishara, 2011; Haniffa & Hudaib, 2007; Bjerke & Al-Meer, 1993). As a result, family blockholders, who dominate corporate boards in Saudi Arabia, provide certain families with the ability to practice favoritism and personal

relations for the appointment at the board as well as executive positions (Ali, 1990; Di Benedetto & Berg, 2009; Falgi, 2009; Ali, 2005; Bukhari, 2014; Piesse et al., 2011). Therefore, few firms can actually be considered as publicly owned, where the investing public have a true representation in their boards through independent directors (Almajid, 2008; Bukhari, 2014).

Consequently, executive managers and board members in the vast majority of the Saudi corporate environment become heavily pressured by the influence set by their appointees, either the government or the controlling families, to work for their best interest, even at the expense of minority shareholders' interests (Alshehri, 2012). The problem is exacerbated when given the fact that many board members and executives were appointed not based on their qualifications and merits, rather based on their relationship with the controlling blockholder (Bishara, 2011).

While the Saudi law protects the rights of shareholders, such as taking derivative actions against the directors of the company in the case of wrongdoings, there is no specific rulings for minority shareholders in particular, who might find it difficult to challenge powerful blockholders and their representatives (Lessambo, 2014). Combining poor minority shareholder protection with favoritism and kinship in the appointment of board memberships, ultimately, controlling blockholders become the main principal in Saudi public listed firms at the expense of minority shareholders (Falgi, 2009; Alshehri, 2012; Piesse et al., 2011) due to the uncontestable power they posses

in deciding on who sits on the board, the appointment of the executive team, and managing the direction of the firm.

Ali (1990) argues that in Muslim lives there seems to be a contradiction between the ideal, the guidance of *Sharia*, and reality, actual practice by Muslims. Like the principle of *Shura*, consultation, for example, which is often contradicted by the means of authoritative autocratic approaches in the Arab Islamic world. In Saudi Arabia, not only stakeholders are neglected from decision making, through a proper representation in the board such as in two tier board systems, minority shareholders have little influence over the appointment of board members, corporate decision making and the direction of the firm.

2.7 Conclusion

This chapter presented an overview of the Saudi Arabian context in order to set the scene for the empirical investigation on the role blockholders play in the governance of Saudi PLCs. The chapter started with a brief history and background of the country, followed by the past and current state of the economy and the capital market. A discussion on the Corporate Governance in Saudi public listed companies was proposed, with an aim to reflect on the key decision makers and primary principals of public listed firms.

An emphasis has been given to the role of corporate governance in protecting the interests of shareholders, and stakeholders at large, as well as the wide presence and influence of blockholders in the Saudi stock market. In an

underdeveloped national governance system similar to most developing countries, blockholders become more capable of expropriating firm resources at the expense of minority shareholders. As a result, it becomes important to examine how these controlling blockholders influence the governance of public listed companies in the Saudi market.

Saudi Arabia is a country that is rooted in the Islamic religion and Arab culture. The massive growth Saudi Arabia enjoyed in the past couple of decades following the discovery of oil made it a country that enjoys great influence over the world economy. Saudi Arabia has the largest capital market in the region, and has ambitions to grow further and attract foreign investors into the market with an aim to diversify its reliance on oil.

Islam as a religion, and the Islamic economic system, promotes ethical dealings, the involvement of various stakeholder groups and the development of societal welfare and discourages greed, selfishness and unjust actions. However, the Saudi corporate legal system has been heavily influenced by Western models that emphasize shareholder supremacy, as opposed to the Islamic stakeholder model.

Most of the Saudi public listed companies are controlled by different types of blockholders, who represent the main principal in the Saudi capital market. Given the significant role the Saudi economy plays in the region and the world at large, it is crucial to investigate the role that controlling blockholders play in the

governance of Saudi PLCs in order to understand the level of protection minority shareholders enjoy under such circumstances.

The next three chapters empirically investigate the influence of different blockholder types present in the Saudi market on three key governance mechanisms, namely: board independence; dividend policy; and audit quality, respectively.

Chapter Three

Blockholders and the Structure of the Board

3.1 Introduction

The aim of the thesis is to examine the role of blockholders in the governance of Saudi public listed companies. In doing so, this chapter will focus on the influence of blockholders in shaping the structure of the board of directors, specifically in terms of the level of minority shareholder representation through independent directorships. The board of directors is generally regarded as the most significant governance mechanism, which in turn influences the overall governance of the firm (Adams et al., 2010). Therefore it is vital to analyze the role blockholders play in the composition of the board in order to better understand the governance environment of Saudi PLCs.

3.1.1 Research Context and Background

Saudi Arabia, similar to other emerging and developing countries, is characterized by an underdeveloped national governance system, where laws and regulations regarding the governance of corporations are either absent entirely or cannot be effectively enforced (Yoshikawa et al., 2014). Consequently, external governance mechanisms, such as the take over market, become weak and inactive (Mishra, 2011; Young et al., 2008). As a result, internal governance mechanisms, such as the board of directors, become more significant in safeguarding shareholders' interests (Douma et al., 2006; Munisi et al., 2014).

Furthermore, Saudi Arabia is characterized by the wide presence of blockholders, who control more than two thirds of Saudi listed companies

(Quttainah & Paczkowski, 2012). In dispersed ownership structures the main agency problem is between shareholders and managers [Principal-Agent or simply P-A]. However, in concentrated ownership structures the problem shifts between controlling and minority shareholders [Principal-Principal or simply P-P] (Young et al., 2008; Shleifer & Vishny, 1997).

It is argued that external governance mechanisms, which are assumed to alleviate the basic Principal-Agent problem such as the takeover market, fail to control Principal-Principal agency problems due to the strong position blockholders enjoy (Setia-Atmaja et al., 2009). Setia-Atmaja et al. (2009) contend that “other internally determined governance mechanisms (i.e., dividends, debt and board structure) may prove more significant in controlling Agency Problem II [P-P]” (Setia-Atmaja et al., 2009, p.864).

Similarly, Anderson and Reeb (2004) argue that in closely controlled firms minority shareholders heavily rely on the board of directors to mitigate blockholder expropriation, as alternative governance mechanisms that solve Principal-Agent problems appear to be ineffective under the presence of a controlling blockholder. Expropriation might be achieved through several forms: by direct or indirect extraction of physical resources, by misallocation of key organizational positions, or by following strategic decisions that advances personal goals at the expense of firm performance (Denis & McConnell, 2003; Young et al., 2008)

3.1.2 Research Motivation and Significance

The board of directors is generally regarded as the most significant governance mechanism (Daily, Dalton & Cannella, 2003; Fama, 1980; Adams et al., 2010). The board of directors is a primary mechanism for minority shareholders to safeguard their interests (Quttainah & Paczkowski, 2012). Being the apex of internal governance, the board is expected to alleviate both P-A and P-P agency problems (Anderson & Reeb, 2004; Fama, 1980; Setia-Atmaja et al., 2009), even in Saudi Arabia (Quttainah & Paczkowski, 2012).

While the board of directors is supposed to be the ultimate internal monitor, it is so as long as it represents the interests of minority shareholders. Due to the fact that controlling shareholders are able to influence board member choice, via their superior voting power, therefore their presence might undermine the board's ability to properly serve its monitoring role, especially when the board lacks adequate independent representation (Young et al., 2008). Therefore examining the relationship between ownership and board structure is a critical area of investigation in the Saudi context, where the presence of controlling blockholders is widespread.

Unlike studies on the impact of board characteristics on firm performance, which are "among the most extensively researched topics in the large body of corporate governance research" (Ben-Amar et al., 2013, p.86), few studies have actually addressed the ownership and board structure relationship in depth (Fraile & Fradejas, 2014; Munisi et al., 2014).

3.1.3 Functioning of the Board

Scholars have identified two major roles that the board of directors play in the organization, namely 'control' and 'resource provision' (Hillman & Dalziel, 2003; Adams et al., 2010). The control, or monitoring role is the oversight of the executive management by board members (Johnson et al., 1996; Fama & Jensen, 1983). This monitoring role, which is generally associated with the agency theoretical perspective, is reflected in the tasks of hiring, firing, and compensating executives (Daily, Dalton & Cannella, 2003; Fama & Jensen, 1983).

The resource provision role, on the other hand, refers to the aptitude of board members in providing resources to the firm (Hillman & Dalziel, 2003; Pfeffer & Salancik, 1978). In that sense, board members contribute to the firm by acting as 'boundary spanners' who provide counsel and advice, facilitate access to resources, build relations with and link the firm to external stakeholders and entities, provide legitimacy, and assist in the formulation of strategic and key decisions (Daily et al., 2003; Hillman, Withers, & Collins, 2009).

Regarding the two roles boards fulfill, diversity of members of the board of directors can be divided into two major classifications (Ben-Amar et al., 2013). On one hand, statutory diversity, which reflects the monitoring role that is best achieved through director independence (Ben-Amar et al., 2013; Jensen & Meckling, 1976). Statutory diversity denotes to the legal classification of the board member: executive, affiliate or independent. Out of the three board member types, independent directors are assumed to represent the interests of

minority shareholders (Anderson & Reeb, 2004; Ben-Amar et al., 2013; Jensen & Meckling, 1976).

On the other hand, demographic diversity, such as gender, culture, education and experience, represents the degree of resource provision directors can provide for the firm (Ben-Amar et al., 2013; Hillman, Nicholson, & Shropshire, 2008). The resources that a board can provide comprise the 'board capital'. Board capital, as Hillman & Dalziel (2003) describes, consists of both human and relational capital. While human capital represents the experience, expertise and reputation of board members, relational capital, on the other hand, represents the networks to other entities and external constituents board members provide (Hillman & Dalziel, 2003).

As this study is interested in the governance role of board monitoring that protects minority shareholder interest under the presence of different blockholders, the focus will be on the statutory diversity of the board through the independent representation of its members. Higher board representation of minority shareholder interests through independent directors is expected to alleviate both P-A and P-P problems (Anderson & Reeb, 2004; Setia-Atmaja, Haman, & Tanewski, 2011; Setia-Atmaja et al., 2009).

Munisi et al. (2014) contend that indeed all studies on the ownership and board relationship focus on the monitoring role of the board, which is reflected in the statutory diversity of its members. Although studying director's demographic diversity under different ownership structures is a fruitful area for

research, however, no disclosure of such data is available in Saudi Arabia, it is, therefore, not possible to conduct such investigation.

3.1.4 Literature Gap

Given that board members are elected by shareholders, it is no surprise that several studies find ownership structure to be a key determinant of board structure (Munisi et al., 2014; Fraile & Fradejas, 2014; Rediker & Seth, 1995; Kim et al., 2007; Chen & Al-Najjar, 2012; Mak & Li, 2001; Li, 1994). Most research on the determinants of board structure mainly focused on managerial ownership as the ownership structure variable, and was carried out primarily in Anglo-American contexts (Lasfer, 2006; Boone et al., 2007; Coles et al., 2008; Linck et al., 2008).

Limited research investigate the role of outside blockholders as a determinant of board structure (Rediker & Seth, 1995; Li, 1994; Mak & Li, 2001; Sur et al., 2013). Additionally, fewer studies do investigate the ownership and board relationship in non Anglo-American contexts, such as South-East Asia (Chen & Al-Najjar, 2012; Chizema & Kim, 2010; Li, 1994; Su, Xu, & Phan, 2008), Continental Europe (Li, 1994; Fraile & Fradejas, 2014; Baglioni & Colombo, 2013), and most recently Sub-Saharan Africa (Munisi et al., 2014).

However, few studies on the determinants of board structure have been carried out in the Middle East. The Middle East is an area with extremely distinctive institutional arrangements, where Islamic religion, Arabian culture and authoritarian governmental rulings play an imperative role in the countries

of the region (Bukhari, 2014). In this region, Saudi Arabia serves as a suitable candidate to investigate such relationship for several reasons.

Firstly, the Saudi capital market is the largest in the region, therefore providing rich empirical data (Tadawul, 2014; Koldertsova, 2010). Secondly, Islam plays a direct role in the legal system of the country, as *Shariah*, Islamic law, serves as its constitution (CIA, 2014). Finally, Saudi Arabia showed high economic and political stability in a time of global financial crises and regional turmoil; the credit crunch and the Arab Spring (Viñals & Ahmed, 2012; Jones, 2013).

Considering independent directors as a reflection of minority shareholder representation, this study aims to investigate the role of blockholders as a determinant of board independence in a newly investigated setting of Saudi Arabia. Therefore, the study seeks to answer the research question of, What is the influence of blockholders on the composition of the board in Saudi Arabia? Specifically, the objective is to empirically examine the influence of different blockholder types on board independence.

The next section provides the theoretical framework of the study. The following section reviews the extant literature on the theoretical predictions and empirical evidence on the ownership and board independence relationship and develops the hypotheses of the study. Subsequently, the methodology of the study employed will be presented. The results and discussion will follow. And finally the study will end with concluding remarks.

3.2 Theoretical Framework

This section will review the main theories that explain the blockholder and board relationship in general. The use of multi-theoretic perspective enables the researcher to better analyze the complexity of the phenomena surrounding organizations, and aids in understanding relationships and influencing factors (Boyd & Solarino, 2016; Christopher, 2010). It is important, however, for the use of a multi-theoretical perspective to have theories with commonalities and that are relevant to the focus of the study (Chen & Roberts, 2010). Accordingly, the main theory of the study is the agency theory, which reflects both the principal-agent and the principal-principal problem, and will be further supported by the views of stewardship, stakeholder and resource dependence theories will be presented.

3.2.1 Agency Theory

The modern form of public incorporation is characterized by the separation in ownership and control rights. From an agency theoretical perspective, the separation of ownership and control rights causes various problems, mainly due to the information asymmetry that exists between shareholders [principals] and managers [agents] (Fama & Jensen, 1983; Jensen & Meckling, 1976). Since managers know more about the company and the business they operate, the risk of them engaging in opportunistic behavior increases, particularly when “important decision agents do not bear a substantial share of the wealth effects of their decisions” (Fama & Jensen, 1983, p. 301).

Various agency costs associated with safeguarding shareholder's wealth arise, which might affect firm value (Jensen & Meckling, 1976). The total agency costs incurred are monitoring costs, bonding costs and residual losses. Monitoring costs, which are incurred by the principal, are the costs associated with monitoring managerial behavior as well as placing interest alignment incentives of agents. Bonding costs, on the other hand, are financial and non-financial costs incurred by the agent to signal to the principals that he is acting in their best interest. Finally, residual losses are any possible losses of potential profits to shareholders due to managerial misconduct (Jensen & Meckling, 1976).

In order to mitigate the agency problem and minimize the associated agency costs, various governance mechanisms have evolved overtime. These mechanisms are either internal or external to the corporation. Internal governance mechanisms include the board of directors, mutual supervision by managers, debt financing, compensation contracts and blockholder monitoring. External governance mechanisms include the takeover market, legal shareholder protection, the product markets competition, and the managerial labor market (Daily et al., 2003; Durisin & Puzone, 2009). By reducing agency costs, these mechanisms are assumed to positively influence corporate performance (Jensen & Meckling, 1976).

Small-dispersed shareholders are generally diversified through small ownership stakes in numerous firms. Such an ownership structure causes free-rider problems (Grossman & Hart, 1980). Small shareholders are expected to suffer from shareholder apathy, due to their insufficient power and economic

incentives to monitor the management (Shleifer & Vishny, 1986; Denis & McConnell, 2003).

By contrast, blockholders possess greater power and incentives to intervene in case managers diverge from the shareholder maximization goal (Shleifer & Vishny, 1986; Becker et al., 2011; Jensen & Meckling, 1976). Blockholders utilize their high voting rights to elect directors, vote on change to corporate strategy, raise resolutions with the current management or engage in proxy contests (Edmans & Manso, 2011; Cronqvist & Fahlenbrach, 2009). Blockholder, therefore, are expected to improve firm value, through the shared benefits of control, by aligning the interests of managers with that of shareholders, as well as reducing the cost of monitoring the management via other mechanisms (Wang & Shailer, 2015; Shleifer & Vishny, 1997).

As opposed to the shared benefits of control, the private benefits of control occur when blockholders abuse their power and expropriate the firm's resources (Chang, 2003; Djankov et al., 2008; Jiang et al., 2010; Barclay & Holderness, 1989). Consequently, blockholders detriment firm value by engaging in expropriate behavior at the expense of minority shareholders (Huyghebaert & Wang, 2012).

Expropriation might be achieved through several forms: by, direct or indirect, extraction of physical resources, such as tunneling; by misallocation of key organizational positions to family or group related personnel, such as board memberships and/or the CEO; or to follow strategic decisions that advances

personal goals at the expense of firm performance, such as family or political agendas in the form of excess unrelated diversification (Chang, 2003; Djankov et al., 2008; Jiang et al., 2010; Barclay & Holderness, 1989; Denis & McConnell, 2003; Young et al., 2008; Huyghebaert & Wang, 2012).

Thus, while blockholder presence might substitute for the requirement of managerial monitoring by the board, minority shareholders still require adequate independent board representation in order to protect their interests from expropriation.

From an agency theory perspective, independent directors are presumably considered to be in a better position than inside, executive, directors toward alleviating the P-A and P-P agency problems (Fama, 1980; Fama & Jensen, 1983; Setia-Atmaja et al., 2009). The board of directors' role as an "ultimate internal monitor" mediates these agency problems (Fama, 1980). Even though there are many responsibilities that the board of directors should perform, the board's oversight role, as supported by *agency theory*, is considered as the boards' most crucial role (Zahra & Pearce, 1989; Fama, 1980).

By increasing the percentage of independent non-executive directors on the board, minority shareholders ensure that blockholders and "managers are not the sole evaluators of their own performance" (Haniffa & Hudaib, 2006).

3.2.2 Stewardship Theory

While agency theory addresses the principal agent relationships in terms of interests divergence, Davis et al. (1997) argue that the causes of interest

alignment are ignored in the agency theory perspective, and that stewardship theory has been introduced to explain the “relationships based upon other behavioral premises”. Stewardship theory argues that managers (agents) aren’t necessarily motivated by individual goals; rather they are motivated to work in the best interest of the owners (principals). The relationship in this case is highly influenced by trust, collectivism and self-actualization rather than the economic self-serving behavioral concepts, such as opportunistic behavior, that have dominated the field of organizational theory and business policy (Davis et al., 1997).

In general, stewardship theory argues that better financial performance is likely to be achieved when managers are granted greater power and authority (Fox & Hamilton, 1994). Consequently, stewardship theory opposes the argument of agency theory, as it assumes that less independent boards are associated with better financial performance. They argue that as the number of executive directors increase, the board functions more productively; as inside directors better understand the nature of the business they manage, hence they make better decisions (Davis et al., 1997).

Furthermore, Saudi Arabian population is comprised entirely of Muslims. Under Islam, all humans are regarded as custodians, vicegerents, of *Allah* [God], and are entrusted to use all the available resources efficiently and equitably for the benefit of the entire community (Iqbal & Lewis, 2009; Abdul Rahman, 1998).

By advocating the principle of accountability and vicegerency, humans are seen as stewards who are supposed to act in the best interest of all. Thus, under Islamic jurisdiction, lowered board independence should not be considered as a minority shareholder expropriation concern, as the blockholders themselves, their representatives and the management team who sit on the board are all expected to act as stewards in the best interests of minority shareholders.

While the Islamic teachings promote stewardship behavior, which is expected to be acted upon by all Muslims, it does not reflect the reality of Muslims around the world (Ali, 1990). Therefore, although it is plausible to assume that stewardship theory should form the basis of analyzing the governance in Saudi Arabia from a religious point of view, the actual conduct within the Islamic world offers greater support to the self-serving agency model instead.

3.2.3 Stakeholder Theory

A stakeholder can be defined as any individual or group who is affected by or is able to affect the achievement of firm objectives (Freeman & Reed, 1983). With a focus on the overriding obligations to the wide organizational stakeholders, based on trust and cooperativeness, stakeholder theory presents a shift away from agency theory, which takes a narrow perspective that focusses on the sole interests of shareholders (Chen & Roberts, 2010; Gaur et al., 2015).

Stakeholder theory calls for aligning the interests of all stakeholder groups, therefore, it should be important to have representatives from these groups in the board, however, it is difficult and unrealistic to identify all of a firm's stakeholders (Gaur et al., 2015). Stakeholder theory proponents argue that

larger and more competent boards are able to better serve the interests of a wider group of stakeholders, and that firms should balance the interests of its various stakeholders (Chen & Roberts, 2010; Gaur et al., 2015).

Gaur et al. (2015) argue that blockholders tend to influence decision making to their interests, even if it was at the expense of other stakeholders. While in two tier board structures the interests of a wider group of stakeholders is fairly reflected, it is difficult to achieve such influence in single tier board structures, such as that present in Saudi Arabia (Bezemer et al., 2014). Ultimately, stakeholders tend to demand the appointment of independent board members to better protect their interests under blockholder control (Bammens et al., 2011).

Consequently, in addition to the agency expectation where independent board members serve the best interest of minority shareholders, the stakeholder model is also in support of increased board independence that is expected to represent the interests of a wider group of stakeholders.

Islamic religion, or *Sharia*, promotes the representation of various stakeholders, in which the main objective of the firm isn't profit maximization, rather, continuity and societal welfare are the fundamental objectives of the Islamic ethical system (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015). Moreover, Islamic teachings encourage collective decision making under the Islamic principle of *Shura*, i.e. consultation in decision making, which takes into consideration the opinion and input of various stakeholders, both direct and indirect.

While these principles represent a foundation for a stakeholder view of the firm, in which increased *representation* of various stakeholders at the board level is essential, such as in a two-tier board system, it is not the case in the actual practice of Saudi boards. The Saudi legal system is based on the Anglo-American single-tier board system and emphasizes on the protection of shareholders at large without providing detailed measures and tools that help various stakeholders as well as minority shareholders to protect their interests and convey their voices (Almajid, 2008; Fallatah & Dickins, 2012; Piesse et al., 2011). Consequently, this study will still consider agency theory as its main theoretical perspective and possibly reflect on the relevant theories, such as stakeholder, for support.

3.2.4 Resource Dependence Theory

Scholars have identified two major roles that the board of directors play in the organization, namely 'control' and 'resource provision' (Hillman & Dalziel, 2003; Adams et al., 2010). The control, or monitoring, role is the oversight of the executive management by board members (Johnson et al., 1996; Fama & Jensen, 1983). This monitoring role, which is generally associated with the agency theoretical perspective, is reflected in the tasks of hiring, firing, and compensating executives (Daily et al., 2003).

The resource provision role, on the other hand, refers to the aptitude of board members in providing resources to the firm (Hillman & Dalziel, 2003; Pfeffer & Salancik, 1978). In that sense, board members contribute to the firm by providing counsel and advice, facilitate access to resources, build relations with

and link the firm to external stakeholders and entities, provide legitimacy, and assist in the formulation of strategic and key decisions (Daily, Dalton & Cannella, 2003; Hillman et al., 2009; Bammens et al., 2011).

The theoretical foundations of the resource provision function are based on Pfeffer and Salancik's (1978) resource dependence theory (Hillman & Dalziel, 2003), as the widely adopted agency theory failed to explain the resource provision functions of the board (Daily, Dalton & Cannella, 2003; Bammens et al., 2011). Resource dependence theory describes the organizational dependence on contingencies in the external environment (Pfeffer & Salancik, 1978).

According to the resource dependence theory, board members act as 'boundary spanners' linking the corporation with its environment, by facilitating access to external resources that are critical to the firm's success, offering expert advice (Hillman et al., 2009), as well as bringing reputation and critical business contacts to the firm (Haniffa & Hudaib, 2006). The benefits as well as the accessibility to these resources enhance the functioning, performance, and survival of the firm (Haniffa & Hudaib, 2006; Daily, Dalton & Cannella, 2003).

The common classification of the different board members, as insider; outsider; executive; non-executive; or independent, has been widely used by researchers in analyzing the board members' roles from both the agency theory as well as the resource dependency perspectives (Hillman et al., 2009).

While these classifications are more suitable for the agency theory standpoint, where the agency problems are alleviated by the monitoring and ratifying roles of the independent board members, the resource dependence can be reflected on much wider classifications, as they are supposed to provide the firm with access to external resources (Hillman et al., 2000).

For the sake of consistency, as this study is conducted from an agency theory perspective, and for data limitations, the common classification of board members' statutory diversity will be applied to the resource dependence theory as well, where independent directors are expected to provide better access to resources to the firm on top of their monitoring role. Therefore, independent board members become significant for minority shareholders as they improve monitoring and provide access to valuable resources to the firm.

The next section will review the extant literature on the theoretical predictions and empirical evidence on the ownership and board independence relationship and develop the hypotheses of the study for the different blockholder types present in Saudi Arabia.

3.3 Literature Review and Hypotheses Development

Blockholders could be considered as both a solution and a cause of agency problems. On the one hand, blockholders have higher incentives and greater power, than small dispersed shareholders, to intervene in case management diverge from shareholder's goal, thus solving the P-A problem between managers and shareholders (Shleifer & Vishny, 1986; Becker et al., 2011; Jensen & Meckling, 1976). On the other hand, controlling blockholders might be inclined to pursue private benefits to the detriment of minority shareholders, due to their uncontestable power, thus causing the P-P problem (Shleifer & Vishny, 1997; Young et al., 2008). In both cases the role of the board of directors in safeguarding shareholder interest is of key interest, where board effectiveness is reflected in its level of independence (Anderson & Reeb, 2004).

Despite the dual agency problems associated with blockholders, strangely, very few studies actually consider the possible P-P agency problem in their analysis of the ownership and board structure relationship (Fraile & Fradejas, 2014). Rather the main focus of blockholders presence is the assumed monitoring role that large shareholders play in the governance of corporations, thus serving as a substitute for board monitoring (Chen & Al-Najjar, 2012; Li, 1994; Munisi et al., 2014; Rediker & Seth, 1995). While this might be the case in developed economies with a strong legal framework that holds all related parties accountable (La Porta, Lopez-de-Silanes, et al., 2000), in developing economies blockholders might also be inclined to expropriate minority shareholders (Djankov et al., 2008).

In such a context, minority shareholders heavily rely on the board to safeguard their interests (Anderson & Reeb, 2004; Fraile & Fradejas, 2014; Setia-Atmaja, Haman, & Tanewski, 2011). While blockholders are able to influence, to a great extent, the composition of the board through their high voting rights, they become able to appoint a board that assists them in expropriating firm resources (Young et al., 2008). However, in order to signal their legitimate intentions towards minority shareholders, blockholders might be inclined to appoint a more independent board that reflects the interests of minority shareholders as well (Setia-Atmaja et al., 2011; Pfeffer & Salancik, 1978). Therefore, regardless of the blockholder motivations, whether to monitor the management or expropriate firm resources, higher independent representation would be beneficial for minority shareholders in a context that is characterized by both types of agency problems.

While the principal principal agency P-P problem is well established in the literature (Renders & Gaeremynck, 2012), studies on the ownership and board structure often overlook such a problem even in developing countries (Chen & Al-Najjar, 2012; Munisi et al., 2014). In a recent study, Fraile and Fradejas (2014) assert that they are the first to study the ownership and board relationship while differentiating between the P-A and P-P agency problems, and how board composition, of outsiders and independents, is supposed to alleviate both. They study the ownership and board relationship in the Spanish context, which similar to Saudi Arabia is characterized by wide blockholder presence and weak external governance. They find that minority shareholder interests are not

sufficiently represented, through board representation, under the presence of blockholders in the Spanish context.

Different types of blockholders, such as family and government, are expected to have different motivations, incentives, risk preferences and ability to influence firms (Ben-Amar et al., 2013; Sur et al., 2013). Recent studies show that indeed different shareholders have heterogeneous preferences, motivations and skills (Kim, 2010; Tihanyi et al., 2003; Sikavica & Kessler, 2013; Hoskisson et al., 2002; Cronqvist & Fahlenbrach, 2009; Guthrie & Sokolowsky, 2010) which, in turn, influence corporate policies and governance structures differently (Cronqvist & Fahlenbrach, 2009; Sur et al., 2013).

Similarly, Desender et al. (2013) stress the importance of differentiating between blockholder types when considering their influence on board structure. However, most research on ownership and board structure relationship combine different blockholder types together, thus expecting them to have homogeneous preferences (Mak & Li, 2001; Fraile & Fradejas, 2014; Rediker & Seth, 1995; Kim et al., 2007; Li, 1994; Lasfer, 2006; Chen & Al-Najjar, 2012). Only one study differentiates between various blockholder types in analysing the ownership and board relationship (Sur et al., 2013), and it is carried out in Canada, which does not represents the context of a developing country.

This study will focus on the main types of blockholders present in the Saudi market. In Saudi Arabia the presence of family, corporate and government ownership is prominent, where more than 80% of listed companies have at least a single blockholder (Quttainah & Paczkowski, 2012; Lessambo, 2014). However,

there is no presence of institutional blockholders in Saudi Arabia, while foreign investors are not allowed to invest in the stock market, as of 2015 (Quttainah & Paczkowski, 2012; Di Benedetta & Berg, 2009).

Furthermore, a unique ownership type in Saudi Arabia is royal family blockholders. Members of the royal family in Saudi Arabia are clearly identifiable due to their unique surname, *Al-Saud*, and generally enjoy political and relational advantages to other citizens of the country (IISS, 2000). Therefore, royal family blockholders can be viewed as politically connected blockholders.

Multiple large shareholders are assumed to have a role in the governance of corporations (Attig et al., 2009). Boubaker, Cellier, & Rouatbi (2014) argue that multiple large shareholders protect minority shareholders from expropriation by blockholders. In Saudi Arabia, the presence of multiple blockholders, of different types in the same company, is very common (Quttainah & Paczkowski, 2012).

Additionally, Attig et al. (2008, p.721) claim that “most empirical studies focus little, if any, attention on the role of multiple large shareholders in corporate governance”. Indeed, no study on the ownership and board relationship has been found that utilizes the influence of multiple blockholders. This study aims to address this gap by analyzing the relationship between ownership and board structure while considering the role of multiple large shareholders.

Most previous studies mainly focus on the ratio of outside directors, being non-executive or affiliated directors, as a measure of board composition (Chizema & Kim, 2010; Donnelly & Kelly, 2005; Lasfer, 2006; Li, 1994; Mak & Li, 2001; Munisi et al., 2014), while few studies consider the ratio of independent directors as a true measure of board independence (Baglioni & Colombo, 2013; Chen & Al-Najjar, 2012; Su et al., 2008; Kim et al., 2007). The former is mainly due to the lack of data availability that clearly distinguishes independents from overall outside directors.

Two recent studies consider both measures for specific purposes (Sur et al., 2013; Fraile & Fradejas, 2014). Sur et al. (2013) argue, and find empirical support, that based on their unique imperatives, institutional blockholders prefer independent directors, and corporate blockholders prefer outside directors in the Canadian market. Similarly, Fraile and Fradejas (2014) indicate that in Spain outside directors are representatives of blockholders, while independent directors represent minority shareholders interests.

However, that is not the case in Saudi Arabia, as outside directors might also reflect the interests of management, where a first degree relative of any senior executive falls under this category (CMA, 2010). Thus, their categorization and rationale for classification choice does not represent the reality of possible material relationship between the related parties in the Saudi context. This study is concerned with the protection of minority shareholder interests, which is best represented by independent directors who enjoy complete independence from the management as well as blockholders.

Table 3.1 presents an overview of previous studies on the ownership and board composition relationship. In the subsequent sections, relevant literature and theoretical arguments will be reviewed for each blockholder type, in order to develop the hypotheses of the study.

Table 3.1 Empirical Studies on Board Independence and Ownership Structure

Authors & date	Country	Dependent variable(s)	Independent variables which proved significant	Results
Fraile and Fradejas (2014)	Spain	- Outside directors %	- Insider ownership	- Non Linear U shaped for insider ownership and outside directors
		- Independents %	- Blockholder ownership (at 5% level)	- Negative decreasing relationship for blockholders & independence
Munisi et al. (2014)	Sub-Saharan Africa	Outside directors %	- Ownership concentration (at least 5%)	- Negative relationship
			- Government Ownership (%)	- Positive relationship
Baglioni & Colombo (2013)	Italy	Independents %	- Top 3 % Ownership	- Negative relationship
			- Family ownership (dummy)	- Negative relationship
Sur et al. (2013)	US	- Inside directors %	- Individual/Family %	- Positive relationship between Individual/Family ownership and Insiders
		- Affiliated directors %	- Corporate %	- Positive relationship between Corporate ownership and Affiliates
		- Independents %	- Institutional %	- Positive relationship between Institutional ownership and Independents
Donnelly & Kelly (2005)	Ireland	Outside Directors %	Executive director ownership %	Negative relationship
Chen & Al-Najjar (2012)	China	Independents %	- Ownership concentration (Herfindahl index of largest 5 shareholders)	- Negative relationship
			- State Ownership %	- Negative relationship
			- Managerial ownership %	- Positive relationship

Su et al. (2008)	China	Independents %	Ownership Concentration (Herfindahl index of largest 10 shareholders)	Nonlinear U shaped relationship
Chizema & Kim (2010)	Korea	Outside directors %	- Foreign Ownership %	- Positive relationship
			- Ownership Concentration %	- Negative relationship
Mak & Li (2001)	Singapore	Outside Directors %	- Managerial Ownership %	- Negative relationship
			- Government Ownership (dummy at 20%)	- Negative relationship
Lasfer (2006)	UK	Outside directors %	Managerial ownership %	Negative relationship
Li (Li, 1994)	Multi-country	Outside Directors %	- Ownership Concentration (dummy at 5%)	- Negative relationship
			- Bank ownership (dummy at 5%)	- Negative relationship
			- State ownership (dummy at 5%)	- Positive relationship
Kim et al. (2007)	Multi-Country (Europe)	Independents %	Ownership Concentration % (at 5% level)	Negative relationship

Notes:

1) Outside directors % = number of non-executive directors / total number of board members

2) Independents % = number of independent directors / total number of board members

3) Inside directors = number of executive directors / total number of board members

4) Affiliated directors = Outside directors

3.3.1 Family Blockholders

Family blockholders are the most common type of concentrated ownership around the world (Singal & Singal, 2011; La Porta et al., 1999). Family control represents a distinctive type of blockholder. Family blockholders, in general, hold non-diversified portfolios, tend to be long-term oriented, and often hold senior managerial positions, thus placing them in a unique position to monitor and influence the firm (Shleifer & Vishny, 1997).

Several studies have found that family controlled firms outperform their non-family counterpart (Anderson & Reeb, 2003; van Essen, Carney, Gedajlovic, & Heugens, 2014; Villalonga & Amit, 2006). These findings support the argument that family members are well informed and maintain close attachment to the firm, resulting in decreased agency problems, and ultimately better performance (Villalonga & Amit, 2006).

Furthermore, Sur et al. (2013) argue that family blockholders remain closely involved in firms' activities, thus hardly rely on additional monitoring by outside directors. Based on a behavioral theory of ownership, they argue that family blockholders favor inside directors in order to maintain full control and follow their ideology and aspirational objectives. They study the relationship between ownership and board structure in Canada, and find support for their argument, where family ownership was positively and significantly related to insider representation on the board.

Likewise, Desender et al. (2013) argue that family blockholders act as a substitute for board monitoring. They study how ownership structure influences the monitoring role of the board in Continental Europe. The level of audit fees contracted by the board measures the degree of the board's monitoring role. They found support for their argument, as firms with family blockholders showed a weaker relationship between board independence and audit fees, hence family blockholders substituted for the monitoring function of the board.

Similarly, Baglioni and Colombo (2013) argue, and find support for, that family blockholders substitute for independent director's monitoring in Italy. Their results show that family ownership leads to less independent representation. In developed national governance systems, such as the US, indeed the ability of family blockholders to expropriate minority shareholders is insignificant, however, in less developed ones, the incentives for family blockholders to expropriate becomes much higher, in which the Italian context reflect such scenario (Mancinelli & Ozkan, 2006; La Porta et al., 1999; Fallatah & Dickins, 2012). Therefore, the rationalization of Baglioni and Colombo (2013) might not represent the reality of the relationship between family and minority shareholders through the level of board independence.

Family blockholders are also expected to produce Principal-Principal agency problems. Uncontestable entrenched family owners might harm minority shareholders through various forms, such as pursuing non-value maximizing familial political agendas, expropriating firm resources in the form of tunneling or excess perks, or assigning senior positions to under qualified family members

(Anderson & Reeb, 2004; Setia-Atmaja et al., 2009). These actions result in Principal-Principal agency problems that harm firm value at the detriment of minority shareholders.

Anderson and Reeb (2004) investigate the role of board composition in family controlled firms in the US. They find that family firms with higher board independence are the best performing firms. Additionally, they find that family firms with low board independence perform considerably worse than non-family firms. Their results stress the importance of independent board members in the protection of minority shareholders from family opportunism. Thus, shedding light on the significance of board independence in mitigating conflicts of interest between shareholder groups [family and minority], rather than between managers and shareholders. They conclude by arguing that on one hand family blockholders monitor the firm, while on the other hand independent directors monitor the family.

Setia-Atmaja et al. (2009) investigate the role of internal governance mechanisms, including board structure, in family controlled Australian listed firms. They argue that due to weak external governance mechanisms in Australia, family owners will be more inclined to expropriate firm resources, therefore, assigning a less efficient board, in terms of independence. They find empirical support for their argument, where family firms demonstrate lower board independence levels compared to non-family firms, thus supporting the expropriation argument.

Saudi Arabian culture is characterized by high power distance, strong level of secrecy in corporate dealings, strong familial ties and a weak national governance system (Robertson et al., 2013; Ali, 2009; Bjerke & Al-Meer, 1993). Furthermore, Bukhari (2014) conducted a qualitative enquiry on the corporate governance institutions in Saudi Arabia and reported that controlling families dominate the board as well as corporate decision making. Family blockholders in Saudi Arabia are therefore expected to maintain their strong authority over the firm and its board, and will thus rely less on independent directors. Ultimately, family blockholders maintain a position that enables them to expropriate minority shareholders. Therefore the first hypothesis is as follows:

H1. *There is a negative relationship between family ownership and the proportion of independent directors in Saudi Arabia.*

3.3.2 Royal Family Blockholders

Saudi Arabia has remained a monarchy for more than 80 years under the rule of the *Al Saud* Family (Long & Maisel, 2010). Consequently, members of the Saudi royal family enjoy political and relational advantages to other citizens of the country (IISS, 2000). Therefore, they can be considered as politically connected individuals similar to politicians in other countries (Faccio, 2010). Royal family members do not represent the government; rather they represent themselves as individuals with their own set of interests and motivations.

The literature shows several advantages for firms that are politically connected, such as ease of access to finance, lower tax rates and preferential treatment by the government in the form of lower regulatory oversight or

financial bailout in times of distress (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2014; Claessens, Feijen, & Laeven, 2008; Faccio, Masulis, & McConnell, 2006; Faccio, 2006; Khwaja & Mian, 2005). These benefits are unique to politically connected firms, and thus puts them in a better position when compared to their non-politically connected counterparts.

However, politically connected firms might represent higher tendencies to expropriate minority shareholders, due to their lower risk of punishment (Bona-Sánchez et al., 2014; Khwaja & Mian, 2005). Researchers have shown that minority shareholders in China are less likely to be protected under the presence of a politically connected blockholder through less compliance with regulations (Berkman et al., 2010), by appointing under qualified board members (Fan et al., 2007), and even having less independent boards (Ding et al., 2014).

Similarly, Saudi royal family blockholders are expected to be able to control board appointments for their benefit, while overlooking the interests of minority shareholders and not bearing the risk of punishment, which results in a principal agency problem. Accordingly, the second hypothesis is as follows:

H2. *There is negative relationship between royal family ownership and the proportion of independent directors in Saudi Arabia.*

3.3.3 Government Ownership

Government ownership is widely present, especially in less developed countries, and they tend to own large shares in previously privatized firms as well as other listed companies directly. Governments, either central or local such

as municipalities, have different objectives from other types of owners, either political, economical or other incentives (Megginson & Netter, 2001; Dharwadkar et al., 2000). However, few studies considered the role of government ownership on board structure, and their arguments and findings vary considerably (Chen & Al-Najjar, 2012; Munisi et al., 2014; Li, 1994; Mak & Li, 2001).

On one hand, Chen and Al-Najjar (2012) argue that government ownership is generally associated with ineffective governance in China, and thus are expected to lead to less board independence. Similarly, Mak and Li (2001) state that government ownership reduces incentives to adopt strong governance in Singapore. This is mainly driven by the fact that firms with significant government ownership are associated with “weaker accountability for financial performance, easier access to finance, lack of exposure to the market for corporate control and weaker monitoring by shareholders” (Mak & Li, 2001, p.240). Both studies find support for their arguments, as government ownership is found to be negatively related to independent and outside board representation, respectively, resulting in a typical principal principal agency problem.

On the other hand, Li (Li, 1994) argues that under government ownership, it is particularly necessary for the board of directors to signal its accountability and legitimacy to the public by appointing more outside directors. Similarly, Munisi et al. (2014) argues that government ownership in Sub-Saharan Africa should signal good governance practice to the market. They find support for their

argument as government ownership is associated with better corporate governance practices, through higher outside board representation.

The government of Saudi Arabia aims at improving the corporate governance of the market, which is reflected in the recent issuance and revision of the corporate governance code (CMA, 2010), as well as its intention to open the market for foreign investors (CMA, 2014). The Saudi government played an important role in the development of the capital market and corporate governance in the past decade and should act as stewards towards other investors in firms they invest in (Bukhari, 2014). It is therefore expected that government ownership in Saudi will signal to the market its intentions to implement governance best practices by increasing the independent representation of its boards. Consequently, the third hypothesis is as follows:

H3. *There is a positive relationship between government ownership and the proportion of independent directors in Saudi Arabia.*

3.3.4 Corporate Ownership

Corporations invest in other firms in order to cultivate distinctive capabilities and technologies through potential synergies, thus their main goal, in general, is not generating short term profits (Sur et al., 2013). According to the resource dependence theory organizations are embedded in a network of social relationships and interdependencies with their environment (Pfeffer & Salancik, 1978). In that sense, organizations remain dependent on external contingencies that are characterized by uncertainty (Hillman et al., 2009). Organizations, therefore, attempt to maintain control over vital resources, by engaging in power

in order to reduce, or manage, environmental dependence and uncertainty. By utilizing their control over resources, organizations aim to limit the power of others over them and increase their power over others (Hillman et al., 2009).

Corporate owners have better understanding of the business environment, and are able to directly monitor the management of the acquired firm by appointing their executives or other affiliates as representatives on the board (Sur et al., 2013; Desender et al., 2013). Ultimately, corporate owners rely less on independent director monitoring. Sur et al. (2013) finds support for this preposition, as they find that corporate ownership is positively related to outside (non-independent) directors in Canada.

As corporate owners are better capable of monitoring the management by appointing skillful affiliates on the board, it is expected that corporate blockholders negatively influence the independence level of the board. Whether this is in the best interest of minority shareholders, when corporate blockholders act as stewards, or not, and cause principal principal agency problems, is beyond the scope of this study. Nevertheless, the fourth hypothesis is as follows:

H4. *There is a negative relationship between corporate ownership and the proportion of independent directors in Saudi Arabia.*

3.3.5 Managerial Ownership

The expected influence of managerial ownership on board structure differs greatly from that of external blockholders. On one hand, the main agency problem [P-A] is expected to be alleviated through increased managerial

ownership, which aligns the interests of managers with that of shareholders as they become owners themselves [incentive alignment]. On the other hand, at higher levels of managerial ownership, where the management power becomes uncontested, managers might be inclined to pursue non value maximization policies, such as excessive perks, at the expense of shareholders [entrenchment effect] (Bennedsen & Nielsen, 2010; Claessens et al., 2002).

Morck et al. (1988) were the first scholars to document the incentive alignment and entrenchment effects of managerial ownership on the performance of US firms. They found that managerial 'incentive' alignment is achieved in low levels of ownership through improved firm performance, whereas at higher ownership levels 'entrenchment' effects occur. Their finding of non-linear relationship was further supported by several later studies (De Miguel, Pindado, & De La Torre, 2004; McConnell & Servaes, 1990; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

Following similar grounds, Fraile and Fradejas (2014) argue that managerial ownership will follow an incentive and entrenchment effect towards the governance structure of the board. Their results show a U shaped non-linear relationship between managerial ownership and the proportion of outside directors on the board, which reflects the tendency towards the need of outside directors at different managerial ownership levels. While the need of outside directors is substituted by incentive alignment of managerial ownership at low levels, the need of outside directors to offset managerial entrenchment at high ownership levels appears.

Managerial ownership is the most empirically examined variable in the ownership and board relationship literature (Fraile & Fradejas, 2014). Several studies find a negative relationship between managerial ownership and board outside directors (Donnelly & Kelly, 2005; Lasfer, 2006; Mak & Li, 2001). Chen and Al-Najjar (2012), on the other hand, find that managerial ownership is positively related to board independence in China.

This study argues that whether it is the incentive effect or the entrenchment effect that influences managerial ownership towards board independence in Saudi Arabia, the relationship would constantly remain negative. While the incentive alignment substitutes for the need of independent directors by shareholders at low managerial ownership levels, entrenched managers at high ownership levels will use their voting power to minimize external monitoring by independent directors in order to extract higher private benefits of control. Accordingly, the fifth hypothesis is as follows:

H5. *There is a negative relationship between managerial ownership and the proportion of independent directors in Saudi Arabia.*

3.3.6 Multiple Blockholders

Multiple large shareholders are assumed to serve a governance role, as the second blockholder is able to limit the largest blockholder expropriation efforts (Pindado & Requejo, 2015; Attig et al., 2008). Research show that the presence of multiple blockholders increases dividend payment (Faccio et al., 2001; Pindado,

Requejo, & Torre, 2012), is related with significant valuation premium (Attig et al., 2008), and is associated with higher corporate risk taking (Mishra, 2011).

Multiple large shareholders are expected to curb the largest blockholder from extracting private benefits of control at the expense of minority shareholders. Due to their ability and incentive to monitor both the largest blockholder and management, multiple blockholders limit minority shareholder expropriation concerns (Boubaker et al., 2014). Consequently, multiple blockholders substitute for the need of independent directors as a minority shareholder representation device.

However, multiple blockholders might also collude with the largest blockholder in order to maximize their private benefit extraction at the expense of minority shareholders, especially in less developed countries (Cai et al., 2016). As a result, multiple blockholders intending to collude with the largest blockholder in minority shareholder expropriation are expected to maintain control over the board in order to remain unchecked. In order to control the board, multiple blockholders are expected to lower the level of board independence, therefore, eluding from monitoring by independent directors.

While no previous studies considered the role of multiple blockholders on the level of board independence, nevertheless, it is expected that multiple blockholders would negatively influence board independence. This negative influence might reflect the case where multiple blockholders substitute for independent directors as a minority shareholder representation device, or in

which multiple blockholders collude with the largest blockholder in appropriative motivations and thus minimize the monitoring capacity of independent directors. In Saudi Arabia, the presence of multiple blockholders, of different types in the same company, is very common (Quttainah & Paczkowski, 2012), however their respective role in corporate governance is much less examined. Therefore, the sixth hypothesis is as follows:

H6. *There is a negative relationship between the presence of multiple blockholders and the proportion of independent directors in Saudi Arabia*

After analyzing the theoretical predictions and empirical evidence on the relationship between different types of blockholders and board structure in order to develop the hypotheses of the study, the next section will present the research methodology employed, which will cover the sample selection, variable measures and model specification of the study. The empirical investigation will help identify the actual role different blockholder types play in the representation of minority shareholders on the boards of Saudi Arabian public listed companies.

3.4 Research Methodology

3.4.1 Sample Selection

The sample of the study comprises all Saudi non-financial public listed companies on Tadawul, the Saudi stock exchange, for the six year period from 2008 to 2013. Tadawul holds 117 traded non-financial listed companies as of September 2014 (ZAWYA, 2014). Excluded from the sample are companies that the full data set variables were not available. A final sample (N) comprises of 619 firm year observations. Table 3.2 shows the total final sample size for each year. Data on board structure and firm level variables are manually collected from published annual reports, while ownership data is obtained from Reuters Thomson One Banker Database.

Table 3.2 Total Firm Samples per Year

Year	2008	2009	2010	2011	2012	2013	Total
N	89	97	102	105	114	112	619

The rationale behind the 2008 start year of the sample is that the disclosure of the 'Board of Directors Report' in the corporate annual report, which discloses the variables required for this study, only became mandatory in 2008 (CMA, 2010), thus data for previous years was impossible to obtain. Furthermore, 2013 was the last year of annual reports available when the data was collected for this research project. Finally, the exclusion of financial firms is justified by their unique business operation and strict legal requirements, as financial companies in Saudi Arabia have their exclusive governance code (CMA, 2010).

3.4.2 Variable Measures

3.4.2.1 Dependent Variable

The dependent variable of the study is the independent representation level of the board of directors (**INED**). This measures the proportion of independent members to total number of board members. Thus regardless of the size of the board, the higher proportion of independent representation the higher the value of **INED**. There are three classifications of directorship in the Saudi market, executive, non-executive and independent directors (CMA, 2010). The definition of independent directors as reported in the Saudi corporate governance code is:

“Independent Member: A member of the Board of Directors who enjoys complete independence. By way of example, the following shall constitute an infringement of such independence:

1. He/she holds a five per cent or more of the issued shares of the company or any of its group.
2. Being a representative of a legal person that holds a five per cent or more of the issued shares of the company or any of its group.
3. He/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group.
4. He/she is a first-degree relative of any board member of the company or of any other company within that company's group.
5. He/she is first-degree relative of any of senior executives of the company or of any other company within that company's group.
6. He/she is a board member of any company within the group of the company which he is nominated to be a member of its board.
7. If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.” (CMA, 2010, pp.3-4)

This study manually identified the independent directors based on the regulatory definition of independence, as some annual reports combine the non-executives with independents in a single category, thus over representing the true independence of the board.

Regarding board composition, the Saudi code requires firms to have a board that comprises of majority non executive directors. Specifically, the code requires the board to have at least two independent directors, or one third of the board size to be independent, which ever is greater (CMA, 2010). However firms are free to increase the number of independent directors to any point above the minimum requirement up to 100%. Therefore, studying the relationship between board independence and blockholder structure would reflect the level of minority shareholder representation the blockholders are willing to endure.

3.4.2.2 Independent Variables

Several ownership variables serve as the independent variables of the study, in order to investigate whether different blockholders prefer distinct board independence levels. The minimum disclosure level of ownership in Saudi Arabia is 5%. Therefore, blockholders of different types will be considered based on the 5% threshold⁶.

The first ownership variable is family ownership (**FMLOWN**). Family ownership represents the percentage ownership of family or individuals from

⁶ Different cutoff points, 5-20%, 20-50%, and >50%, have been examined in order to identify the level of ownership required to maintain influence. Which showed similar results to our combined findings of >5%.

total issued capital. Secondly, royal family ownership will be considered (**RYLOWN**). The percentage ownership of the Saudi ruling family members, *Al-Saud*, to total issued capital measures **RYLOWN**.

The third ownership variable measures the percentage of governmental ownership (**GOVOWN**). The government of Saudi Arabia directly holds shares in companies through three wholly-government-owned investment funds, namely, Public Investment Fund (PIF), Public Pension Agency (PPA) and General Organization for Social Insurance (GOSI) (ZAWYA, 2014). There are no private pension funds in Saudi Arabia thus citizens do not have other choices for retirement schemes. Moreover, only the government has the right to decide on the management and operation of these funds, therefore, it is more suitable to classify them as state ownership rather than institutional investors (Almajid, 2008). Due to the lack of competition and government appointment of the management team, these governmental agencies differ greatly in terms of their investment choices and overall governance from traditional institutional investors.

Fourthly, corporate ownership measures the percentage ownership held by a corporate entity (**CRPOWN**). While corporate ownership is common in Saudi Arabia, these corporations tend to be non-financial in nature. Although some corporations are privately held, which might represent a single family or individual investor, no data of ownership of these companies can be obtained. However, this study overlooked corporate ownership where the corporation's

registered name is of a family or individual and combined them with family owners instead.

The fifth ownership variable is managerial ownership (**EXECOWN**). **EXECOWN** represents the percentage ownership of the firm executive management to total issued capital. Executive management could be the CEO, CFO, COO or any member of the senior management team of the firm.

The presence of multiple large shareholders will be the final ownership variable (**MLS**). A binary/dummy variable that measures 1 if more than one blockholder is present in a single firm, and 0 otherwise. In the case of multiple blockholders from the same family, the study will consider them as a single block, rather than multiple blockholders, due to their similar interests and kinship relations that forms a familial coalition (Jara-Bertin et al., 2008). In the aim of measuring the contestability of other blockholders in preventing the controlling blockholders and/or management from expropriating minority shareholders, it is more reasonable to differentiate between multiple blockholders and clear blockholder coalitions.

3.4.2.3 Control Variables

This study will control for factors that are expected to be a determinant of board independence beside the ownership variables presented earlier. Research shows that certain firm characteristics might be associated with the independence level of the board due to different levels of monitoring and counsel required (Guest, 2008; Boone et al., 2007; Linck et al., 2008; Chen & Al-Najjar,

2012). These differences are associated with firm complexity, monitoring costs and potential private benefits of control (Munisi et al., 2014).

Firstly, prior literature argue that firm performance affects the level of CEO influence and authority, as CEOs of good performing firms can demand less independent boards (Boone et al., 2007; Coles et al., 2008; Guest, 2008; Hermalin & Weisbach, 1998). Poor performing firms, on the other hand, might be inclined to increase board independence to monitor the CEO and/or to avoid criticism for the lack of good governance practices (Chen & Al-Najjar, 2012; Hermalin & Weisbach, 1998). Firm performance is measured through the accounting performance measure of return on assets **(ROA)**.

Secondly, product and/or international diversification represent firm complexity level that might increase the requirements for higher independent representation that provides external monitoring and expert advice to the management (Coles et al., 2008; Pearce & Zahra, 1992; Guest, 2008). Diversification is measured as a binary/dummy variable that takes the value of 1 if the firm has more than one product or international segments, and 0 otherwise **(DIVERS)**.

Thirdly, the size of the firm not only reflects the level of firm complexity, it also represents a higher propensity for expropriation of resources (Jensen, 1986). Therefore, larger firms ultimately require higher independent director representation for monitoring and advice (Boone et al., 2007; Coles et al., 2008). Firm size is measured using the natural logarithm of total assets **(FSIZE)**. Firm sales is another measure of firm size used in the literature, however, several

listed companies in our sample are recent start ups, thus don't have sales figures, therefore using total assets as the measure of size is more reasonable.

Fourthly, firms with high levels of free cash flow face increased agency costs and managerial discretion due to the potential of private benefits extraction (Jensen, 1986; McKnight & Weir, 2009). Free cash flow might be expropriated by either the management and/or controlling blockholders in various ways, such as tunneling, investments in negative net present value projects, or excessive perquisites (Jensen, 1986; La Porta, Lopez-de-silanes, et al., 2000; Wang & Xiao, 2011). Consequently higher free cash flow requires additional monitoring to be provided by independent directors (Munisi et al., 2014). In order to control for differences in firm size, free cash flow is measured as the level of cash holding divided by total assets (**FCF**) (Adjaoud & Ben-Amar, 2010).

Fifthly, the leverage level the firm maintains might influence its board independence level in two ways. On one hand, debt is considered as a governance mechanism that reduces free cash flow available for managerial and/or controlling blockholder discretion, thus resulting in lower requirement for higher board monitoring through independent directors (Jensen & Meckling, 1976; Jensen, 1986; McKnight & Weir, 2009; Fraile & Fradejas, 2014). On the other hand, higher debt is an indication of firm complexity, thus resulting in higher requirement for monitoring and advice by independent directors (Coles et al., 2008; Munisi et al., 2014). The leverage level is measured as total debt divided by total assets (**LEVERG**).

Finally, external auditors provide independent checks on the financial and accounting statements of the firm. The literature emphasized the benefits of having an expert auditor with long standing history, as these auditors possess advance knowledge and skills in addition to their reputational concerns (Mansi et al., 2004; DeAngelo, 1981). The well-known international auditors, which are generally referred to as the 'Big Four' (KPMG, Ernst & Young, PricewaterhouseCoopers and Deloitte), reflect such size and long standing.

These so called Big Four all operate in the Saudi market and provide auditing services to numerous public listed companies. Assigning a Big Four auditor does have its drawbacks, as audit fees would ultimately be much higher (Desender et al., 2013). Therefore, it is expected that firms that assign a Big-Four auditor demonstrate higher tendency to induce higher costs for the promotion of better governance, thus might employ a higher level of board independence. The presence of a Big Four auditor is measured as a binary/dummy variable that takes the value of 1 if the firm has one of the Big Four as its external auditor, and 0 otherwise (**BIG4**).

3.4.3 Model Specification

To test the hypotheses developed that aims to answer the research question of the study the following model has been used:

$$\text{INED}_{i,t} = \alpha_0 + \beta_1 \text{FMLOWN}_{i,t} + \beta_2 \text{RYLOWN}_{i,t} + \beta_3 \text{GOVOWN}_{i,t} + \beta_4 \text{CRPOWN}_{i,t} + \beta_5 \text{EXECOWN}_{i,t} + \beta_6 \text{MLS}_{i,t} + \beta_7 \text{ROA}_{i,t} + \beta_8 \text{DIVERS}_{i,t} + \beta_9 \text{FSIZE}_{i,t} + \beta_{10} \text{FCF}_{i,t} + \beta_{11} \text{LEVERG}_{i,t} + \beta_{12} \text{BIG4}_{i,t} + \text{INDDUM} + \varepsilon$$

where:

α_0 :	Intercept
i:	Firm factor
t:	Year factor
INDDUM	Industry dummy
β :	Regression coefficient
ε :	Error term

Table 3.3 presents the operationalization of the variables used in the model. The following section provides the results of the econometric models, as well as the discussion of the findings.

Table 3.3 Operationalization of Variables

Variable		Measure
Dependent variable		
Board Independence	INED	The percentage of Independent Non-executive Directors sitting on the board = Number of Independents over Total Number of Board Members
Independent variables		
Family Ownership	FMLOWN	The percentage of Family Ownership = Family Ownership over Total Issued Capital
Royal Family ownership	RYLOWN	The percentage of Royal Family Ownership = Royal Family Ownership over Total Issued Capital
Government Ownership	GOVOWN	The percentage of Government Ownership = Government Ownership over Total Issued Capital
Corporate Ownership	CRPOWN	The percentage of Ownership by other Corporate Entities = Corporate Ownership over Total Issued Capital
Managerial Ownership	EXECOWN	The percentage of Managerial Ownership = Executive Ownership over Total Issued Capital
Multiple Large Shareholders	MLS	The presence of more than one Blockholder in a single Firm (value of 1 if yes and 0 otherwise)
Control variables		
Firm Performance	ROA	ROA = Net Income before tax divided by Total Assets
Diversification	DIVERS	Product and/or International Diversification (value of 1 if yes and 0 otherwise)
Firm Size	FSIZE	The natural log of Total Assets
Free Cash Flow	FCF	Level of Free Cash Flow = Cash Holdings over Total Assets
Firm leverage	LEVERG	Total Debt divided by Total Assets
Big Four Auditor	BIG4	External Auditor is one of the Big Four (value of 1 if yes and 0 otherwise)
Additional variables (Robustness Checks)		
Board Size	LBSIZE	The natural log of the Total Number of Board Members

3.5 Results and Discussion

3.5.1 Descriptive Statistics

Table 3.4 provides information on the descriptive statistics of variables measured. The table reports that on average 45% of board members are independent directors, while this ratio ranges from 0% to 100% in the entire sample. The major ownership category is family ownership, where on average they hold 17% of the issued equity. Conversely, royal family ownership is the least manifested category, with average ownership of about 3%.

However, royal family ownership displays the largest maximum level of ownership of 95%, this is only reflected in a single company of 'Kingdom Holding Company' where HRH Prince *Alwaleed Bin Talal* owns 95% of the issued shares and also serves as the chairman of the board. Both government and corporate ownership on average hold about 9% of share capital, while managerial ownership is on average only 5%. The presence of multiple blockholders is a common theme, where more than one blockholder in a single company is found in around two thirds of the sample.

Furthermore, the figures in Table 3.4 reflect that the variables are not normally distributed across the sample. The skewness of several variables fall beyond ± 1.96 , and the kurtosis mostly fall beyond ± 2 , which reflect the thresholds acceptable for normality (Hair et al., 2010). Therefore, utilizing OLS as an estimation method for our model is inappropriate, as it will produce biased estimates. Consequently, this study will employ fixed effects (FE) or random effects (RE) techniques to test the model.

Table 3.4 Descriptive Statistics for Dependent, Independent and Control Variables

Variables	Min	Max	Std. Dev.	Mean	Median	Skewness	Kurtosis	N
INED	0	1	0.179	0.450	0.4	0.803	3.366	619
FMLOWN	0	0.725	0.216	0.172	0.0815	1.168	3.033	619
RYLOWN	0	0.95	0.116	0.028	0	5.828	41.623	619
GOVOWN	0	0.836	0.177	0.087	0	2.598	9.415	619
CRPOWN	0	0.75	0.160	0.089	0	1.983	6.254	619
EXECOWN	0	0.7	0.133	0.049	0	3.476	14.942	619
MLS	0	1	0.479	0.645	1	-0.604	1.365	619
ROA	-0.672	0.494	0.105	0.069	0.06	-0.938	12.938	619
DIVERS	0	1	0.498	0.546	1	-0.185	1.034	619
FSIZE	17.795	26.55	1.646	21.53	21.3971	0.566	3.389	619
FCF	0	0.668	0.085	0.062	0.0346	3.473	19.335	619
LEVERG	0.004	1.527	0.219	0.365	0.3359	0.700	4.136	619
BIG4	0	1	0.475	0.656	1	-0.656	1.432	619

The distribution of different types of blockholders in the market, based on market sector and firm size, is reflected in Figure 3.1 and Figure 3.2, respectively. These figures are constructed from the data collected for this study. Family blockholders are found to be fairly present in most sectors and firm sizes, especially in the retail and media sectors as well as medium sized firms, and the least in utility firms, namely from the petrochemical, cement and telecommunication sectors.

Furthermore, royal family blockholders mostly hold considerable shares in the multi-investment and media sectors and to a slightly greater extent in large firms. Government ownership, however, is widely present in the market, mostly in large firms and utility sectors (namely petrochemical, cement, energy, telecom, real estate and transportation). The only exception is the multi-investment sector where the government presence seems to be insignificant. Similarly, corporate ownership is also widely present, predominantly in large firms and the petrochemical and telecom sectors, with the exception of the transportation, media and tourism industries. Moreover, managerial ownership is fairly absent in large firms, and is mostly concentrated in the media and retail sectors.

These findings reveal the wide presence of different blockholder types in the Saudi stock market. Furthermore, the findings reflect the importance of the petrochemical and utility sectors to the government that holds a majority share in these critical sectors and tend to deter family and managers from holding large blocks of shares in them.

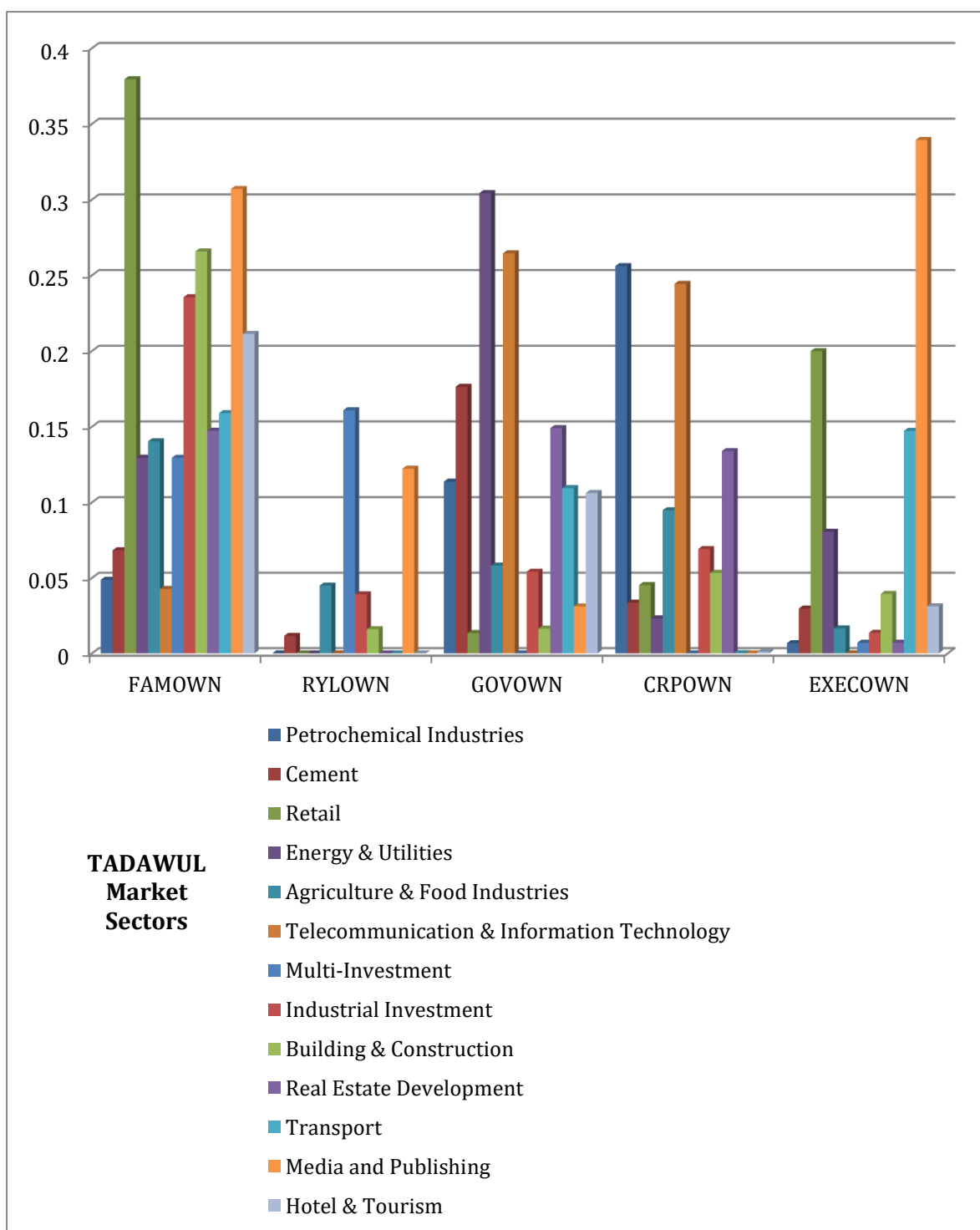


Figure 3.1 Average Ownership of Different Blockholder Types per Market Sector

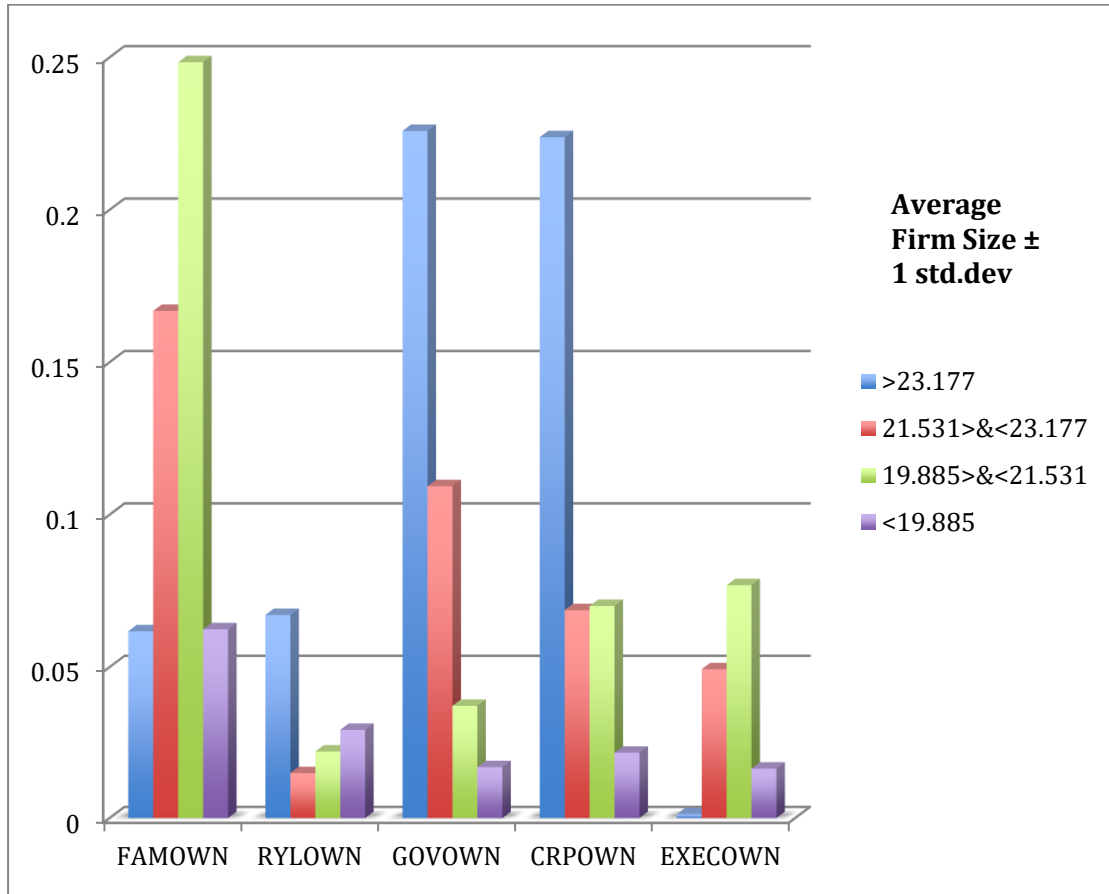


Figure 3.2 Average Ownership of Different Blockholder Types per Firm Size

Table 3.5 presents the correlation matrix for the dependent, independent and control variables. The results show that the correlation between the variables are comparatively low, all below 0.5, thus no indication of a multicollinearity problem in the model (Gujarati, 2003). All the independent variables of ownership are negatively related to the percentage of independent directors except the royal family ownership. Furthermore, the highest correlation between the independent variables, of 0.468, is between family ownership (FMLOWN) and executive ownership (EXECOWN), which reflects that family owners maintain close control of the company and prefer to incentivize the management of their firms by increasing their level of ownership.

Additionally, moderately high correlation is found between firm size (FSIZE) and both leverage (LEVERG) and a big 4 auditor (BIG4), of 0.431 and 0.438 respectively. This reflects the level of firm complexity that demands more qualified auditors as well as easier access to finance due to the larger asset base that serves as a collateral for lenders. Likewise, the correlation between leverage (LEVERG) and a Big Four auditor (BIG4) is 0.422. This could be attributed to the higher risk associated with debt that encourages the appointment of skilled auditors by the firm, or that the appointment of a Big Four auditor is demanded by the lender as a measure to safeguard their interests.

Table 3.6 presents the variance inflation factors (VIF) for the variables, where all fall comfortably within the acceptable limit of less than 10, thus further confirming that multicollinearity is not present (Kutner et al., 2004). The next section will discuss the results of the empirical model as presented in Table 3.7.

Table 3.5 Pearson Correlation Matrix for Dependent and Independent Variables

Variables	INED	FMLOWN	RYLOWN	GOVOWN	CRPOWN	EXECOWN	MLS	ROA	DIVERS	FSIZE	FCF	LEVERG	BIG4
INED	1												
FMLOWN	-0.205	1											
RYLOWN	0.014	-0.144	1										
GOVOWN	-0.062	-0.280	-0.057	1									
CRPOWN	-0.262	-0.293	-0.060	-0.094	1								
EXECOWN	-0.164	0.468	0.036	-0.143	-0.130	1							
MLS	-0.230	-0.019	-0.009	0.292	0.309	-0.111	1						
ROA	-0.064	0.104	-0.138	0.109	0.005	0.216	0.135	1					
DIVERS	-0.235	0.255	0.120	0.055	-0.123	0.178	0.014	0.063	1				
FSIZE	-0.309	-0.134	0.109	0.490	0.303	-0.092	0.376	-0.016	0.344	1			
FCF	0.031	-0.053	-0.073	-0.042	0.027	-0.065	-0.037	0.256	0.025	-0.145	1		
LEVERG	-0.250	0.132	0.047	-0.005	0.208	0.065	0.131	-0.268	0.263	0.431	-0.170	1	
BIG4	-0.298	0.170	0.085	0.132	0.190	0.148	0.251	0.037	0.330	0.438	0.007	0.422	1

Table 3.6 Variance Inflation Factor (VIF) Values

Variable	VIF
FSIZE	2.57
GOVOWN	1.99
FMLOWN	1.90
CRPOWN	1.77
LEVERG	1.64
BIG4	1.53
DIVERS	1.44
EXECOWN	1.44
MLS	1.41
ROA	1.35
RYLOWN	1.18
FCF	1.16
Mean VIF	1.61

Table 3.7 Fixed Effects Panel Data of Board Independence on Ownership Structure and Control Variables

	INED				
	Model 1	Model 2	Model 3	Model 4	Model 5
FMLOWN	-0.258** (-2.52)				-0.246** (-2.43)
RYLOWN	1.033 (1.00)				1.176 (1.14)
GOVOWN	-0.582** (-2.22)				-0.657** (-2.52)
CRPOWN	-0.288* (-1.70)				-0.249 (-1.48)
EXECOWN	-0.001 (-0.01)				0.002 (0.02)
MLS	-0.077*** (-3.22)	-0.079*** (-3.35)	-0.074*** (-3.18)		-0.076*** (-3.25)
OWNCNCTR		-0.283*** (-3.46)			
OWN5TO20			-0.196*** (-5.63)		
OWN20TO50			-0.155*** (-3.78)		
OWNABV50			-0.192*** (-4.26)		
LBSIZE				0.161*** (3.13)	0.163*** (3.24)
ROA	-0.086 (-1.37)	-0.080 (-1.28)	-0.078 (-1.28)	-0.060 (-0.94)	-0.083 (-1.33)
DIVERS	0.081*** (2.70)	0.077** (2.60)	0.079*** (2.74)	0.095*** (3.18)	0.089*** (2.98)
FSIZE	0.046** (2.10)	0.039* (1.84)	0.050** (2.39)	0.031 (1.42)	0.039* (1.79)
FCF	-0.133* (-1.80)	-0.141* (-1.91)	-0.109 (-1.50)	-0.135* (-1.79)	-0.142* (-1.94)
LEVERG	-0.067 (-1.55)	-0.053 (-1.25)	-0.081* (-1.94)	-0.039 (-0.92)	-0.069 (-1.60)
BIG4	-0.004 (-0.28)	-0.002 (-0.14)	-0.002 (-0.16)	-0.008 (-0.49)	-0.008 (-0.52)
Constant	-0.401 (-0.86)	-0.238 (-0.52)	-0.417 (-0.94)	-0.573 (-1.24)	-0.597 (-1.28)
R-sq	0.094	0.088	0.132	0.095	0.113
N	619	619	619	619	619

Notes:

1. ***, ** and * denote p-value significance at 1%, 5%, and 10% level, respectively.
2. t-statistics are in parentheses.

3.5.2 Discussion of Results

Table 3.7 reports the panel data fixed effects (FE) regression Models 1 to 5. The dependent variable in all models is the percentage of independent directors on the board (INED). In order to investigate the relationship between the ownership variables and board independence, and given the nature of the unbalanced panel data set of the study, random effects (RE) and fixed effects (FE) techniques were utilized. Utilizing a panel data set that combines time series and cross sectional observations provides a more informative and robust results due to the higher degrees of freedom (Gujarati, 2003). Further checks reveal that fixed effects (FE) is the appropriate estimation method, as the Durbin–Wu–Hausman test results were significant at the 1% level, namely $\text{Prob} > \chi^2 = 0.0022$ (Wooldridge, 2010; Gujarati, 2003). For robustness checks, Table 3.8 will present the results as tested by the random effects regression in order to further validify the results of the main model.

Model 1, which is the primary model of the study, reports the independent variables of ownership, for the different types of blockholders, along with the firm specific control variables. The results indicate that family blockholders (**FMLOWN**) are negatively and significantly related to board independence (INED) at the 5% level. Therefore, accepting the first hypothesis (H1), where family blockholders in Saudi Arabia disregard the interests of minority shareholders and assign a less independent board. Therefore, family blockholders maintain ultimate control over corporate decision-making in the Saudi context.

This result corroborates the findings of previous literature examining the family ownership and board relationship, where all studies found the relationship to be negative, while the interpretation of the relationship greatly differs (Sur et al., 2013; Baglioni & Colombo, 2013; Setia-Atmaja et al., 2009). While family blockholders might be beneficial if the family acted in the best interest of minority shareholders, however, the risk of family expropriation would be amplified in case their interests diverge due to the lack of independent director monitoring (van Essen et al., 2015; Setia-Atmaja et al., 2009).

On the one hand, Baglioni and Colombo (2013) and Sur et al. (2013) both maintain that family blockholders improve the overall governance of the firm, and thus family ownership substitutes for the need of independent director monitoring, in the Italian and US contexts, respectively. This stewardship rationalization can best symbolize the influence of the Islamic principle of vicegerency, which might impact family blockholders in Saudi Arabia. However, as discussed earlier in section 3.2, the self-interested agency model could also reflect the attitude in Saudi Arabia instead of the Islamic stewardship principles, and that the Arabian culture of secrecy and high power distance might be the driver for maintaining control over the board (Bukhari, 2014; Ali, 2005).

On the other hand, Setia-Atmaja et al. (2009) argue that family blockholders in Australia minimize monitoring by independent directors in order to maximize their private benefits extraction, which is driven by the weak external governance context of Australia that enables controlling families to appropriate firm resources, thus resulting in a principal principal agency problem. Consequently, family blockholders

might expropriate minority shareholder's interests by assigning under qualified family member in key positions, pursue familial agendas instead of profit maximization or by tunneling and direct theft of firm resources (Young et al., 2008; Wang & Xiao, 2011; Pindado & Requejo, 2015). Accordingly, minimizing external monitoring by independent directors makes family blockholders maintain full control over the board, and puts them in an uncontestable position to expropriate firm resources at the expense of minority investors.

Ultimately, in Saudi Arabia, both explanations might hold. It is possible that controlling family blockholders maintain control over the board in order to better monitor the firm in the best interest of all, or to deter external monitoring by independent directors in order to maximize their private benefit extraction. This result also supports the findings of Bukhari (2014), who conducted a qualitative enquiry on the corporate governance institutions in Saudi Arabia and reported that controlling families dominate the board and corporate decision making.

Moreover, royal family blockholders (**RYLOWN**) are found to be insignificantly related to board independence (**INED**), therefore the second hypothesis (H2) of negative relationship is rejected. This finding also differs from previous studies that found politically connected firms to negatively influence the board of director's independence level (Ding et al., 2014), and the qualifications of its members (Fan et al., 2007).

This result, of no relationship, could be attributed to the fact that in more than 90% of firms that have a royal family blockholder in our sample, the royal family member

serves as the chairman of the board himself. Therefore, acting as a chairman enables him to control the board without the need to assign board positions to any desired party, whether executives, non-executives or independents. Ultimately, royal blockholders do not affect the independence level of the board because they control firm decision making by serving as chairmen of the board themselves.

Surprisingly, the relationship between board independence (INED) and government ownership (**GOVOWN**) is found to be negative and significant at the 5% level. This is opposite to the expected hypothesis (H3) where the government is expected to signal good corporate governance practices and encourage the market to improve its overall governance by acting as stewards (Bukhari, 2014), thus the hypothesis is rejected.

This finding is also opposite to that reported by Li (Li, 1994) and Munisi et al. (2014), who found similar results in a multi country sample and Sub-Saharan Africa, respectively. However, this finding supports that found in China and Singapore by Chen and Al-Najjar (2012) and Mak and Li (2001), respectively. Their results reveal that government ownership is generally associated with ineffective governance structures and weaker accountability towards shareholders, as suggested by the agency theory.

However, this result, of negative relationship might reflect that the Saudi government prefers to maintain close control over board decision-making rather than empowering external parties in their firms (Piesse et al., 2011; Almajid, 2008). The case of retaining control from the government could be reinforced by investments in strategic sectors, such as petrochemical and utility companies, where the Saudi

government is generally the controlling blockholder. For example, the Saudi government owns 70% of SABIC (Saudi Basic Industries Corporation), which is the largest listed company in the Middle-East in terms of market capitalization, and 70% of Saudi Telecom, which is the largest telephone service provider in the country (Tadawul, 2014).

Furthermore, corporate ownership (**CRPOWN**) is also found to be negative and significantly related to board independence (INED) at the 10% level. Confirming the prediction of the proposed hypothesis (H4), therefore the hypothesis is accepted. This finding is similar to the results of Sur et al. (2013), who found that corporate ownership is positively related to affiliate directors rather than independent directors in Canada.

Additionally, these findings further corroborate the predictions of the resource dependence theory (Pfeffer & Salancik, 1978) which expects that corporate blockholders substitute for the requirement of an independent board through their advanced monitoring capabilities. Corporate owners have better understanding of the business environment, and are able to directly monitor the management of the acquired firm by appointing their executives or other affiliates as representatives on the board rather than independent directors.

However, managerial ownership (**EXECOWN**) is found to be insignificantly related to board independence (INED), thus rejecting the proposed negative relationship of hypothesis (H5), which reflects both the incentive and entrenchment effects. Likewise, this finding does not support previous results of managerial ownership and board

independence in contexts such as the UK, Spain and Singapore by (2006), (2014) and Mak and Li (2001), respectively.

Moreover, this could reflect the prevalence of power that external blockholders in Saudi Arabia enjoy when compared to internal/managerial owners, where most other blockholder types significantly influenced board independence. This finding is similar to the results of Munisi et al. (2014), where in Sub-Saharan Africa, managerial ownership is also found to be not related to board independence. Therefore, due to the dominant power external blockholders possess in the Saudi context, increased managerial ownership would still not allow for their interests to be reflected in decision making, such as the appointment of directors to the board.

Additionally, the presence of multiple large shareholders (**MLS**) is found to be negatively and significantly related to board independence (INED) at the 1% level. Thus supporting the last hypothesis (H6), which assumes that multiple blockholders will substitute for an increased representation of independent directors. Likewise, as each blockholder will vote himself, or his representative, to hold board seats, there will plausibly be less room for independent directors, due to the limit on board size imposed by the Saudi corporate governance regulation; where board size must be between 3 and 11 (CMA, 2010). Consequently, the presence of multiple blockholders reduces the level of board independence in Saudi Arabia.

While there is a chance that multiple blockholders might collude and expropriate firm resources, it is generally expected that second large shareholders would monitor the largest controlling blockholder from self serving behavior (Barroso Casado et al.,

2016; Attig et al., 2009). Thus, even though multiple large shareholders reduce board independence in Saudi Arabia, it is expected that they will represent the interests of minority shareholders through their stewardship role, and therefore, substituting for the need of independent directors.

Several control variables show significant relationship with board independence. In support to the firm complexity argument, which assumes the need for an increased independent representation, both firm diversification (**DIVERS**) and firm size (**FSIZE**) show a positive significant relationship with board independence (INED) at the 1% and 5% levels, respectively. Firms that are more diversified and firms that are larger are considered as more complex firms, thus require more diverse skills and monitoring efforts, which is expected to be provided by independent board members. This finding is similar to that found in other countries such as the US (Coles et al., 2008), UK (Guest, 2008), China (Chen & Al-Najjar, 2012), and Spain (Fraile & Fradejas, 2014).

Finally, the level of free cash flow (**FCF**) shows significant relationship at the 10% level, where the relationship is negative with board independence (INED). Free cash flow serves as an opportunity for private benefit extraction, thus controlling managers and/or blockholders demand a less independent board that might limit their capacity towards such expropriation in Saudi Arabia. In this case, minority shareholders remain unprotected through the decreased presence of independent directors when the levels of free cash flow are high.

3.5.3 Robustness Checks

In order to further examine the robustness of the results, several models have been employed. Models 2 and 3 in Table 3.7 examine the role of ownership concentration on board independence regardless of the type of blockholder. Model 2 measures the entire combined ownership concentration of over 5% (**OWNCNCTR**), whereas Model 3 divides the level of concentration into three groups; comprising a dummy variable that equals 1 if the total ownership concentration in a firm falls under each threshold of 5% to 20% (**OWN5TO20**), 20% to 50% (**OWN20TO50**) and over 50% (**OWNABV50**), and 0 otherwise. The motivation behind this measurement is to examine whether blockholders of different levels of ownership influence board independence differently or not. Different results for different levels of ownership could signal the incentive and entrenchment effects previously documented in the literature (De Miguel et al., 2004; McConnell & Servaes, 1990; Morck et al., 1988; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

The results of Model 2 demonstrate that ownership concentration (**OWNCNCTR**) is negatively and significantly associated with board independence at the 1% level. This result is similar to the previous findings, as all blockholder types in Saudi Arabia with significant relationship to board independence are found to be negative; namely family, government and corporate blockholders.

Additionally, Model 3 reveals that the blockholder negative influence on board independence is similar at the three different concentration thresholds. All the

three thresholds are found to be negatively and significantly related to board independence at the 1% level. Therefore, no matter what level of ownership the blockholder retains, above 5%, the influence on the independence level of the board in Saudi Arabia is similar. This could reflect the possibility of minority shareholder expropriation by any size of blockholders in Saudi Arabia, who will possess the power to appoint board members, and ultimately, control firm decisions at all levels of ownership.

Models 4 and 5 investigate the influence of board size (**LBSIZE**) on board independence. Board size is calculated as the natural logarithm of the total number of board members. Model 4 excludes the ownership variables, while Model 5 includes all ownership variables along with the board size variable. In both models the board size is found to be positively and significantly associated with board independence at the 1% level. This result indicates that firms tend to appoint independent directors by increasing the number of board seats instead of replacing other executive or affiliated directors. Thus reflecting the demand for retaining control by either executives and/or blockholders, which represent the heart of the principal agent (P-A) and/or principal principal (P-P) problem that independent directors are expected to alleviate.

Furthermore, Table 3.8 presents the main model as tested by the random effects regression. Clarke et al. (2015) posit that “while the Hausman test has a role to play in comparing the estimates obtained from FE [fixed effects] and RE [random effects] models, it does not necessarily provide the definitive answer about which should be preferred” (Clarke et al., 2015, p.264). As the fixed effects

does not control for industry effects, these can be observed in the results of the random effects technique which will be used to further examine the validity of the results. Similarly, the significance of the results from the random effects does not differ at all from that of the fixed effects reported in the study, thus granting further support to our main findings.

Corporate governance research has illustrated the problem of endogeneity concerning board structure and firm characteristics (Demsetz & Villalonga, 2001; Brown et al., 2011; Gippel et al., 2015). For example, board structure might lead to better firm performance, while at the same time, past firm performance might cause a need to change board members. However, this study analyses the influence of ownership structure on board independence, as board members are elected directly by shareholders, hence, it is reasonable to expect that ownership affects board structure rather than the other way around.

Furthermore, the generalised method of moments, or simply GMM, is a viable solution to the endogeneity problem (Lee et al., 2015; Keasey et al., 2015; Pindado et al., 2012). However, as GMM relies on lagged values and the main independent variables of this study, which are ownership structure, tend to be stable over time, therefore GMM becomes unsuitable for such type of data (Andres, 2011; Goergen & Renneboog, 2001).

The following section provides the concluding remarks of this chapter, which includes the main findings and contribution to knowledge.

Table 3.8 Random Effects Panel Data of Board Independence on Ownership Structure, Control Variables and Industry Dummies

	INED
FMLOWN	-0.265 (-4.08)***
RYLOWN	0.033 (0.25)
GOVOWN	-0.202 (-2.15)**
CRPOWN	-0.387 (-4.30)***
EXECOWN	-0.074 (-0.86)
MLS	-0.063 (-3.13)***
ROA	-0.059 (-0.97)
DIVERS	0.014 (0.61)
FSIZE	-0.010 (-0.82)
FCF	-0.125 (-1.80)*
LEVERG	-0.021 (-0.54)
BIG4	-0.003 (-0.20)
Constant	1.01 (3.98)***
Industries	Yes
R-sq	0.345
N	619

Notes:

1. ***, ** and * denote p-value significance at 1%, 5%, and 10% level, respectively.
2. t-statistics are in parentheses.

3.6 Conclusion

This chapter investigated the role of blockholders on the structure of the boards of Saudi public listed companies. The level of board independence under blockholder control reflects the degree of minority shareholder representation in the decision making and governance of the firm.

Random effects (RE) and fixed effects (FE) models were used to test the relationship between different blockholder types, namely family, royal family, government, corporate and managerial ownership, and board independence (INED). After controlling for conventional determinants of board structure, the results for 117 non-financial listed companies in Saudi Arabia from 2008-2013, where a final sample (N) comprises of 619 firm year observations, show that that minority shareholder interests are not well represented through higher level of board independence under control by all types of blockholders.

The findings of the study reveal the existing principal principal agency problem between all types of blockholders and minority shareholders in Saudi Arabia, as the former is associated with less independent board representation. As Table 3.9 shows, family ownership, government ownership, corporate ownership and multiple blockholders have all been found to be significantly associated with less independent boards.

Table 3.9 Summary of Hypotheses and Empirical Findings of Blockholder and Board Structure Relationship

Blockholder Type	Expected	Findings
Family	-	-
Royal Family	-	no
Government	+	-
Corporate	-	-
Managerial	-	no
MLS	-	-

The exclusion of outside independent directors under blockholder control reflects the dominance of the Arabian culture in Saudi Arabia, which is characterized by high power distance and strong level of secrecy in business dealings (Haniffa & Hudaib, 2007; Bukhari, 2014). By allowing increased independent representation on the board, blockholders become obligated to reveal information they otherwise regard as private to outside independent members.

The motivation behind blockholders' control over the board might be to better monitor the firm and act as stewards in the best interest of all, or to deter external monitoring by independent directors in order to maximize their private benefit extraction. The stewardship rationalization can best symbolize the Islamic principle of vicegerency, which is expected to have an influence on blockholders in Saudi Arabia, who should act in the best interest of all

stakeholders. However, as discussed earlier in section 3.2, the self-interested agency model might also reflect the attitude of individuals in Saudi Arabia, who might utilize their strong position to expropriate firm resources.

Ultimately, in Saudi Arabia, both explanations might hold. Whether maintaining control by these blockholders is motivated by favorable or harmful intentions is beyond the scope of this chapter. Nevertheless, the following empirical chapters will aim at further answering this question by examining the influence of blockholders on dividend policy and audit quality, respectively. Triangulating the findings of the three studies will provide better understanding of the role blockholders play in the governance of Saudi public listed companies, and whether they expropriate minority shareholders or not.

This study contributes to the literature in several ways. Firstly, this study provides empirical evidence on the determinants of board structure in a Middle Eastern setting with unique institutional arrangements that has been largely under investigated in the literature. The Arab culture and Islamic religion of Saudi Arabia might greatly influence the determinants of board independence when compared with studies carried out in different contexts, such as the US (Coles et al., 2008), UK (Guest, 2008), China (Chen & Al-Najjar, 2012), Africa (Munisi et al., 2014) and Spain (Fraile & Fradejas, 2014).

Secondly, this study distinguishes between the types of blockholders present in the Saudi market, which includes a unique type of royal family members. Studies on the ownership and board structure relationship generally overlook

such differentiation and combine blockholders in a single category, either internal or external (Mak & Li, 2001; Fraile & Fradejas, 2014; Rediker & Seth, 1995; Kim et al., 2007; Li, 1994; Lasfer, 2006; Chen & Al-Najjar, 2012). It is important to differentiate between different blockholder types in order to examine the respective role of each type separately, and to avoid any biased results that might occur in the econometric models (Sur et al., 2013).

Thirdly, this study contributes to the ownership and board literature by examining the role of the presence of multiple large shareholders (MLS) on the level of board independence. MLS is a relatively newly examined topic in the literature, with no studies utilizing it as a determinant of board structure (Attig et al., 2009; Boubaker & Sami, 2011; Cai et al., 2016; Sacristán-Navarro et al., 2015).

Finally, this study increases our understanding of the dynamics of the Saudi capital market, which is largely understudied, by examining the principal principal problem [P-P] between controlling and minority shareholders. This is achieved by studying the board composition and ownership structure relationship, which reflects the level of minority shareholder representation the market provides under the presence of controlling blockholders. The Saudi market is characterized by wide presence of blockholders, and therefore it is important to understand how they impact minority shareholder representation.

Chapter Four

Blockholders and Dividend Policy

4.1 Introduction

The presence of blockholders poses the threat of expropriating firm resources at the expense of minority shareholders. Due to their strong position; of high voting power, blockholders are expected to directly influence corporate decision making (Djankov et al., 2008). The interests of blockholders, whether economical or political, might greatly differ from that of minority shareholders. Consequently, minority shareholders rely on different means to protect their invested wealth, especially in a less developed country such as Saudi Arabia (Huyghebaert & Wang, 2012; Djankov et al., 2008; Dyck & Zingales, 2004).

In that regard, dividend payments to shareholders is considered a key governance mechanism that alleviates minority shareholder expropriation concerns (Setia-Atmaja et al., 2009; Pindado et al., 2012; Truong & Heaney, 2007). Cash dividend payouts limit the free cash flow available for misuse by controlling blockholders and/or managers, as well as placing the firm under external scrutiny from the capital market (Jensen, 1986; Easterbrook, 1984). This chapter investigates blockholders' influence on the dividend policy of Saudi PLCs, in order to examine the level of governance minority shareholder experience under the presence of controlling blockholders.

4.1.1 Research Context and Background

Saudi Arabia, similar to other emerging and developing countries, is characterized by an underdeveloped national governance system, where laws and regulations regarding the governance of corporations are either absent entirely or cannot be effectively enforced (Yoshikawa et al., 2014). Consequently, external governance mechanisms, such as the take over market, become weak and inactive (Mishra, 2011; Young et al., 2008). As a result, internal governance mechanisms, such as dividend payout, become more significant in safeguarding shareholders' interests (Douma et al., 2006; Setia-Atmaja et al., 2009).

Furthermore, Saudi Arabia is characterized by the wide presence of blockholders, who control more than two thirds of Saudi listed companies (Quttainah & Paczkowski, 2012; Santos, 2015). In dispersed ownership structures the main agency problem is between shareholders and managers [Principal-Agent or simply P-A]. However, in concentrated ownership structures the problem shifts between controlling and minority shareholders [Principal-Principal or simply P-P] (Young et al., 2008; Shleifer & Vishny, 1997).

Consequently, minority shareholders bear the risk of expropriation by controlling blockholders [P-P] on top of the basic managerial agency problem [P-A]. Expropriation might be achieved through several forms: by direct or indirect extraction of physical resources, by misallocation of key organizational positions, or by following strategic decisions that advance personal goals at the expense of firm performance (Denis & McConnell, 2003; Young et al., 2008).

It is argued that external governance mechanisms, which are assumed to alleviate the basic Principal-Agent problem, such as the takeover market, fail to control Principal-Principal agency problems due to the strong position blockholders enjoy (Setia-Atmaja et al., 2009). By reducing the level of free cash flow available for expropriation, Setia-Atmaja et al. (2009) contend that “other internally determined governance mechanisms (i.e., *dividends*, debt and board structure) may prove more significant in controlling Agency Problem II [P-P]” (Setia-Atmaja et al., 2009, p.864).

Thus in a context such as Saudi Arabia, that is characterized by wide blockholder presence and the absence of strong external governance, minority shareholders will heavily rely on dividend payouts, beside other factors, as a governance mechanism that alleviates their risk of being expropriated (Truong & Heaney, 2007; La Porta, Lopez-de-silanes, et al., 2000).

4.1.2 Research Motivation and Significance

The motivation for firms to payout dividends has puzzled financial economists for more than fifty years (Frankfurter & Wood, 2003; Frankfurter & Wood, 2002; La Porta, Lopez-de-silanes, et al., 2000; Denis & Osobov, 2008). The seminal work of Modigliani and Miller (1958; 1961) asserts that in perfect markets dividends are irrelevant to shareholder wealth. Higher dividend payout reduces retained earning and capital gains, while lower dividend payout increases retained earnings and capital gains, leading to unchanged shareholder wealth.

However, in reality, firms tend to maintain a deliberate dividend payout policy, and investors do value dividend payments (La Porta, Lopez-de-silanes, et al., 2000; Lintner, 1956; Pindado et al., 2012). Furthermore, despite the higher tax liability dividends incur in some countries, strangely, shareholders still prefer dividend payments over retained earnings, and stock prices have been found to react positively following dividend announcements (Crockett & Friend, 1988; Frankfurter & Wood, 2002; Easterbrook, 1984).

While the literature could not fully rationalize the determinants of dividends in a single model, both theoretically and empirically, it is rather a combination of factors that is reflected in, but not limited to, the risk tolerance of the investor, agency costs, information transmission, and liquidation costs of holdings, that partially explains the shareholder's preference for dividends (Frankfurter & Wood, 2002; Crockett & Friend, 1988).

The finance literature has extensively examined the determinants of dividend payouts (Denis & Osobov, 2008), and it is well documented that dividends are considered as a governance mechanism that is influenced by the governance structure of the firm (Adjaoud & Ben-Amar, 2010; Pindado et al., 2012; La Porta, Lopez-de-silanes, et al., 2000). Driven by the reduction of free cash flow available for expropriation (Jensen, 1986), and the accompanying monitoring by the capital market (Easterbrook, 1984), which dividend payments incur on corporations, the overall governance of the firm is expected to be improved when firms with high agency costs payout higher dividends (Adjaoud & Ben-Amar, 2010; Pindado et al., 2012; La Porta, Lopez-de-silanes, et al., 2000).

In developed countries, such as the US and UK, dividends are considered as an unwritten contract between shareholders and corporate managers (Frankfurter & Wood, 2002), which is reflected by the dispersed ownership structure of their context that is characterized by the separation of ownership and control. However, in Saudi Arabia, and in developing economies in general, concentrated ownership changes the balance of powers, in which blockholders maintain control over decision making (Djankov et al., 2008; Santos, 2015), including dividends (La Porta, Lopez-de-silanes, et al., 2000). It is therefore imperative to examine the influence of blockholders on dividend policy, in order to examine the level of protection minority shareholders enjoy (Gugler & Yurtoglu, 2003).

4.1.3 Literature Gap

Early literature examining the relationship between ownership structure and dividends has mainly focused on two types of ownership, namely managerial and institutional, and was carried out in the US and UK (Crutchley & Hansen, 1989; Jensen et al., 1992; Short et al., 2002; Rozeff, 1982). Several later studies extended beyond the US and UK into more developing countries, namely Egypt, Malaysia and Jordan, however they only focused on insider and institutional ownership as well (Abdelsalam et al., 2008; Benjamin et al., 2015; Al-Gharaibeh, 2013). Recent studies, albeit limited, incorporated new ownership types in analyzing the ownership and dividend relationship, such as family and government ownership, as these owner types hold large blocks in many countries around the world (Gugler, 2003; Pindado et al., 2012; Khan, 2006; Chen et al., 2005; Djebali & Belanès, 2015).

While these studies generally considered these blockholder types in isolation, only one study, by Djebali & Belanès (2015), did incorporate the different types of blockholders in a single dividend model, however it is based on the developed context of France. Therefore, little is known about the influence of different blockholder types on dividends in a developing context. In that regard, Saudi Arabia represents a developing context with distinctive institutional arrangements, where Islamic religion and authoritarian governmental rulings play an imperative role in the economy, and is therefore a suitable candidate for such study.

Merely two studies examined the determinants of dividend policy in Saudi Arabia (Osman & Mohammed, 2010; Al-Ajmi & Hussain, 2011). Al-Ajmi and Hussain (2011) measured the influence of government and blockholder ownership on dividend payments as part of their model, and found no relationship between blockholders and dividends, while Osman and Mohammed (2010) only considered government ownership and found that it positively influences dividends.

However, both studies only used a dummy variable for blockholder presence, which eliminates the relative power of the degree of ownership concentration the blockholder possesses, and its corresponding effect on dividend decisions. Moreover, they failed to incorporate several important governance mechanisms, such as the presence of multiple blockholders and the independence of the board

of directors, into their model in order to fully analyze the governance role that dividends play in Saudi Arabia.

Additionally, these studies fail to differentiate between different blockholder types; rather they used a combined blockholder measure that treats different owners as a homogenous group. However, different types of blockholders; such as families or corporations, are expected to have different set of skills, capabilities, motivations and investment horizons that makes their influence on dividend policy distinct from one another. This study will focus on the main types of blockholders present in the Saudi market.

Considering dividends as a governance tool that mitigates minority shareholder expropriation, this study aims to fill the gap in the literature and add to the findings of Al-Ajmi and Hussain (2011) and Osman and Mohammed (2010) by investigating the role of blockholders as a determinant of dividend policy in Saudi Arabia. Therefore, this study will comprehensively analyze the role of dividends as a governance mechanism under different blockholder sets; namely family, royal family, government, corporate, managerial and multiple blockholders, in the context of Saudi Arabia, in order to examine the level of governance minority shareholders experience under the presence of controlling blockholders.

Accordingly, this chapter seeks to answer the research question of, to what degree do blockholders impact the dividend policy of Saudi PLCs? Specifically, the objective is to empirically examine the influence of different blockholder

types on dividend policy, of both the decision to pay dividends and the amount the firms actually pay out.

The next section provides the theoretical framework of the study. The following section reviews the extant literature on the ownership structure and dividend policy relationship as well as develops the hypotheses of the study. Afterwards, the research methodology employed will be presented. Subsequently, the results and discussion will follow. Finally, concluding remarks will close the study.

4.2 Theoretical Framework

Several theoretical explanations regarding the determinants of dividend policy have been proposed over the past few decades, and intensive empirical examinations have been employed to test their applicability (Frankfurter & Wood, 2002). Yet no model have been able to fully explain the dividend puzzle (Frankfurter & Wood, 2002; Adjaoud & Ben-Amar, 2010). The major theoretical standpoints on dividends with regards to ownership structure are taxation, agency, signaling and stakeholder (Frankfurter & Wood, 2002; Short et al., 2002; Gaur et al., 2015). This section will review these theories and relate them to the Saudi context in order to build the theoretical framework of the study. The use of multi-theoretic perspective enables the researcher to better analyze the complexity of the phenomena surrounding organizations, and aids in understanding relationships and influencing factors (Boyd & Solarino, 2016; Christopher, 2010).

4.2.1 Tax Effect Hypothesis

One of the first explanations of dividend payment is the different tax treatment of dividends compared to capital gains (Frankfurter & Wood, 2002). Different countries have different taxation policies (La Porta, Lopez-de-silanes, et al., 2000). In the US both high and basic rate income tax payers are better off when profits are retained in the firm rather than paid as dividends, while tax-exempt shareholders are merely neutral in terms of preference between retained earnings and dividends (Short et al., 2002). On the other hand, in the UK, tax-exempt shareholders are better off when profits are distributed in the form of dividends rather than retained in the firm (Short et al., 2002).

These two opposed scenarios encourage different dividend policies that will affect shareholder's wealth differently. Taxation factors is argued to be the foundation behind the high dividend payments found in UK listed firms, which is triggered by the high ownership presence of tax-exempt institutional investors, namely pension funds (Short et al., 2002). The tax effect hypothesis also proposes the 'dividend clientele effect' of different tax levels investors entail, in such that companies attract certain investor types based on their dividend payout policy (Miller & Modigliani, 1961).

However, Saudi Arabia, similar to other countries in the region such as the United Arab Emirates, do not have a personal income tax systems (Al-Kuwari, 2009; Al-Ajmi & Hussain, 2011; Chazi et al., 2011). In such circumstances the tax explanation becomes irrelevant to the dividend policy of the firm, as both income gains from cash dividends and retained earnings are not taxed. Accordingly this

study will disregard the taxation explanation of dividends in studying the effect of blockholders on the dividend payout policy of Saudi PLCs and rely on other theoretical views.

4.2.2 Agency Theory

As the taxation theory failed to justify the payment of dividends when the tax costs of dividends are higher than that of retained earnings, as in the case of US, researchers reflected on the governance role that dividends might play in reducing agency costs (Easterbrook, 1984; Rozeff, 1982). Dividend payout represents a governance mechanism that alleviates both the classical principal-agent problem, between management and shareholders, and the principal-principal agency problem, between blockholders and minority shareholders (La Porta, Lopez-de-silanes, et al., 2000; Setia-Atmaja et al., 2009).

Two factors related to dividend payouts causes the alleviated agency costs to shareholders. Firstly, dividend payment to shareholders decreases the free cash flow available under insider control (Jensen, 1986). Free cash flow unpaid as dividends might be expropriated by controlling blockholders and/or management in various forms, such as excessive perquisites, investment in negative net present value projects, or transfer pricing (Crockett & Friend, 1988; Frankfurter & Wood, 2002). Therefore minority shareholders benefit from dividend payment in the form of reduced free cash flow that might otherwise be expropriated (Sáez & Gutiérrez, 2015).

Secondly, dividend payments are associated with increased monitoring by the capital market (Easterbrook, 1984; Rozeff, 1982). Dividend payments reduce the

funds available for investment opportunities thus require the firm to seek financing from the capital market for its investment needs. This in turn places the firm under external monitoring by the professional capital market, who will limit excessive perquisite consumption and investments in less than optimal projects (Frankfurter & Wood, 2002).

In both cases minority shareholders will be better off by receiving dividend payments that alleviates their expropriation concerns from insider private benefit extraction (Farinha, 2003), either from controlling blockholders and/or powerful managers (La Porta, Lopez-de-silanes, et al., 2000; Sáez & Gutiérrez, 2015; Mancinelli & Ozkan, 2006).

4.2.3 Stakeholder Theory

A stakeholder can be defined as any individual or group who is affected by or is able to affect the achievement of firm objectives (Freeman & Reed, 1983). With a focus on the overriding obligations to the wide organizational stakeholders, based on trust and cooperativeness, stakeholder theory presents a shift away from agency theory, which takes a narrow perspective that focusses on the sole interests of shareholders (Chen & Roberts, 2010; Gaur et al., 2015).

Stakeholder theory calls for aligning the interests of the different stakeholder groups and balancing their interests (Chen & Roberts, 2010; Gaur et al., 2015). Gaur et al. (2015) argue that blockholders tend to influence decision making to their interests, even if it was at the expense of other stakeholders. However, Holder et al. (1998) argue, and find empirical support for their claim, that corporate dividend policy is influenced by the claims of stakeholders other than

debt and equity holders. They find that corporate focus, in terms of firm size and diversification, is negatively related to dividend payout, which reflects that more focused firms reduce dividend payouts to preserve liquidity and indicate their preparedness to meet implicit and explicit claims to stakeholders (Holder et al., 1998).

Islamic religion, or *Sharia*, promotes the representation of various stakeholders, in which the main objective of the firm isn't profit maximization, rather, continuity and societal welfare are the fundamental objectives of the Islamic ethical system (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015). However, the Saudi legal system is heavily influenced by the Anglo-American system and emphasizes on the protection of shareholders at large without providing detailed measures and tools that help various stakeholders as well as minority shareholders to protect their interests and convey their voices (Almajid, 2008; Fallatah & Dickins, 2012; Piesse et al., 2011).

Therefore, although it is plausible to assume that stakeholder model should form the basis of analyzing the governance in Saudi Arabia from a religious point of view, the actual conduct within Saudi Arabia offers greater support to the self-serving agency model instead.

4.2.4 Signaling Theory

Signaling theory rationalizes dividend payment as a signal that conveys information to the market, due to the information asymmetry that exists between corporate insiders and the external market. Corporate executive managers, who run the day-to-day operations of the firm, are reasonably more informed about

the performance of the firm from the general public (Fama & Jensen, 1983). Additionally, blockholders, who have the power and incentive to closely monitor the firm, are also more informed about firm performance (Jiang et al., 2011). Both executive managers and controlling blockholders are able to influence corporate decision making, including dividend payments (Mancinelli & Ozkan, 2006; Farinha, 2003; Adjaoud & Ben-Amar, 2010).

By distributing dividends to shareholders, firms might signal information regarding the expected future earnings of the firm (Miller & Rock, 1985), the severity of the agency problem it faces (Short et al., 2002; Truong & Heaney, 2007), and the way it treats its shareholders (Frankfurter & Wood, 2002). Several empirical studies found a positive relationship between dividend announcement and stock prices, which reflects that dividends might signal expected future growth in profits, while a cut in dividends signals an expected decline in future profits (Asquith & Mullins, 1986; Miller & Rock, 1985; Frankfurter & Wood, 2002).

The signaling characteristics of dividends could also be considered as a solution to the agency problem, as dividend payments reduce information asymmetry between insiders and outside shareholders. Furthermore, controlling insiders, both management and/or blockholders, might signal their good treatment of minority shareholders in order to attract investors to acquire their stocks, or to gain preferential financing from the capital market (Short et al., 2002; Truong & Heaney, 2007; Pindado et al., 2012). The payment of high

dividends in firms under blockholder control signals the commitment by the blockholder not to expropriate minority shareholders (Pindado et al., 2012).

In conclusion, under both the signaling and agency theory expectations, minority shareholders are expected to prefer dividends over retained earnings in order to alleviate the problems associated with public listed companies, between management and shareholders, as well as the problems associated with the presence of a controlling blockholder, between blockholders and minority shareholders. Consequently, dividends act as a vital internal governance mechanism against minority shareholders expropriation.

Given that Saudi Arabia has a widespread presence of controlling blockholders and an absence of strong external governance framework, dividend payments are in the best interest of minority shareholders. Instead of expropriating firm resources, minority shareholders are better off when blockholders distribute dividends to shareholders in the context of Saudi Arabia. Whether dividends affect the free cash flow available for expropriation or signal the treatment of firm resources and its shareholders, higher dividends are beneficial to minority shareholders, while lower dividends are harmful to minority shareholders.

The next section will review the extant literature on the theoretical predictions and empirical evidence on the ownership structure and dividend policy relationship, as well as develop the hypotheses of the study for the different blockholder types present in Saudi Arabia.

4.3 Literature Review and Hypotheses Development

The determinants of dividends has attracted vast attention from researchers over the past four decades with an aim to solve the so called 'dividend puzzle' (Baker et al., 2002; Miller & Modigliani, 1961; Frankfurter & Wood, 2002; Denis & Osobov, 2008). While conventional studies on the determinants of dividends barely consider the governance role of dividend in their analyses, few studies do incorporate a wider view of corporate governance in explaining dividend policy (Adjaoud & Ben-Amar, 2010; Pindado et al., 2012; Setia-Atmaja et al., 2009; Jensen et al., 1992).

The finance literature has extensively examined the determinants of dividend payouts (Denis & Osobov, 2008), and it is well documented that dividends are considered as a governance mechanism that is influenced by the governance structure of the firm, especially its ownership structure (Adjaoud & Ben-Amar, 2010; Pindado et al., 2012; La Porta, Lopez-de-silanes, et al., 2000). Early literature examining the relationship between ownership structure and dividends has mainly focused on two types of ownership, namely managerial and institutional, and was carried out in the US and UK (Crutchley & Hansen, 1989; Jensen et al., 1992; Short et al., 2002; Rozeff, 1982).

Imbedded in the classical agency problem between management and shareholders, due to the dispersed ownership context of the US, Jensen (1986) Rozeff (1982) and Easterbrook (1984) all developed models that reflected the relationship between ownership structure and dividends. In these models managerial ownership is at the root of the discussion, where higher managerial

ownership negatively impacts dividends, while outside blockholders overcome managerial entrenchment. Similarly, studies conducted on the UK examined ownership by institutional blockholders on dividend policy, and found that large institutional ownership increase dividend payouts (Short et al., 2002; Khan, 2006).

Several later studies extended beyond the US and UK into more developing countries, namely Egypt, Malaysia and Jordan, however they only focused on insider and institutional ownership as well (Abdelsalam et al., 2008; Benjamin et al., 2015; Al-Gharaibeh, 2013). While managerial and institutional owners are important types of blockholders, they are not the most common outside of the US and UK, where family ownership prevails, followed by government ownership (La Porta et al., 1999).

Recent studies, albeit limited, incorporated new ownership types in analyzing the ownership and dividend relationship, such as family and government ownership, as these owner types hold large blocks in most countries around the world. While these studies offered insights on the governance role of dividends under the presence of a blockholder in contexts such as Europe (Djebali & Belanès, 2015; Mancinelli & Ozkan, 2006; Pindado et al., 2012), South America (Gonzalez et al., 2014), and East Asia (Chen et al., 2005; Bradford et al., 2013), no studies have thoroughly examined the dividend and blockholder relationship in a Middle Eastern setting while considering the various existing types of blockholders.

Merely two studies examined the determinants of dividend policy in Saudi Arabia (Osman & Mohammed, 2010; Al-Ajmi & Hussain, 2011). Al-Ajmi and Hussain (2011) measured the influence of government and blockholder ownership on dividend payments as part of their model, and found no relationship between blockholders and dividends, while Osman and Mohammed (2010) only considered government ownership and found that it positively influences dividends.

However, both studies only used a dummy variable for blockholder presence, which eliminates the relative power of the degree of ownership concentration the blockholder possesses, and its corresponding effect on dividend decisions. Moreover, they failed to incorporate several important governance mechanisms, such as the presence of multiple blockholders and the independence of the board of directors, into their model in order to fully analyze the governance role that dividends play in Saudi Arabia.

Additionally, these studies fail to differentiate between different blockholder types; rather they used a combined blockholder measure that treats different owners as a homogenous group. However, different types of blockholders; such as families or corporations, are expected to have different set of skills, capabilities, motivations and investment horizons that makes their influence on dividend policy distinct from one another. This study will focus on the main types of blockholders present in the Saudi market.

In Saudi Arabia the presence of family, corporate and government ownership is widely noted, where more than 80% of listed companies have at least a single blockholder (Quttainah & Paczkowski, 2012). However, there is no presence of institutional blockholders in Saudi Arabia, while foreign investors are forbidden from investing in the stock market, as of 2015 (Quttainah & Paczkowski, 2012; Di Benedetto & Berg, 2009). Furthermore, a unique ownership type in Saudi Arabia is royal family blockholders. Members of the royal family in Saudi Arabia are clearly identifiable due to their unique surname, and generally enjoy political and relational advantages to other citizens of the country (IISS, 2000).

Multiple large shareholders are assumed to have a role in the governance of corporations (Attig et al., 2009). Boubaker, Cellier, & Rouatbi (2014) argue that multiple large shareholders protect minority shareholders from the expropriation by blockholders. In Saudi Arabia, the presence of multiple blockholders, of different types in the same company, is very common (Quttainah & Paczkowski, 2012). Thus, this study will consider the dividend policy of firms under family, royal family, government, corporate, managerial and multiple blockholder control, in order to reflect the minority shareholders' treatment and expropriation concerns under different ownership structures.

Table 4.1 presents an overview of previous studies on the ownership and dividend relationship around the world, as well as the determinants of dividends in Saudi Arabia. In the following sections, relevant literature and theoretical arguments will be reviewed for each blockholder type, in order to develop the hypotheses of the study.

Table 4.1 Empirical Studies on Dividends and Ownership Structure

Ownership - Dividends					
Author and Date	Country	Empirical Test	Dependent Variable(s)	Independent Variables	Significant Results
Abdelsalam et al. (2008)	Egypt	Logit and OLS	<ul style="list-style-type: none"> - Dividend Decision - Dividend Ratio 	<ul style="list-style-type: none"> - Managerial Ownership % - Blockholder Ownership % - Institutional Ownership % - Free Float % 	<ul style="list-style-type: none"> - Positive relationship between institutional blockholders and dividend decision and dividend ratio - Positive relationship between ROE and dividend decision and dividend ratio
Alajmi and Hussain (2011)	Saudi Arabia	Tobit (for smoothing), Logit (for dividend decision) and Fixed Effects (for dividend ratio)	<ul style="list-style-type: none"> - Dividend Adjustment - Dividend Decision - Dividend Per Share 	<ul style="list-style-type: none"> - Previous Dividend - Profitability (EPS) - Cash Flow (Cash Flow per Share) - Firm Size (log of assets) - Leverage (debt to assets) - Blockholder Dummy (at 10%) - Government Ownership Dummy (at 10%) - Life Cycle (retained earnings to common equity) 	<ul style="list-style-type: none"> - Positive significant relationship between lagged dividend, EPS, CFPS, life cycle and dividend decision and ratio - Positive relationship between firm size and dividend decision - Negative relationship between leverage and dividend decision

Osman and Mohammed (2010)	Saudi Arabia	Tobit (for dividend payout) and Probit (for dividend decision)	<ul style="list-style-type: none">- Dividend Yield- Dividend to Assets- Dividend Decision	- Tangibility (Non current assets to total assets)	<ul style="list-style-type: none">- Positive relationship between Profitability, Size, Government Ownership and Maturity with both Dividends Payout and Dividend Decision for non-financial firms- Negative relationship between Leverage and Business Risk with both Dividend Payout and Dividend Decision for non-financial firms- Positive relationship between Profitability and Size with both Dividend Payout and Dividend Decision for financial firms- Negative relationship between Business Risk and both Dividend Payout and Dividend Decision for financial firms
				- Profitability (ROA)	
				- Firm Size (log of sales)	
				- Leverage (debt to assets)	
				- Agency Costs (log of number of shareholders)	
				- Business Risk (std dev. of ROI)	
				- Government Ownership Dummy (at 10%)	
				- Maturity (firm age)	
				- Tangible Assets (non current assets to total assets)	
				- Growth Opportunity (market-to-book ratio)	
Al-Kuwari (2009)	GCC	Tobit	<ul style="list-style-type: none">- Dividend Payout Ratio	- Government Ownership %	- Positive relationship between Government Ownership, Size, and Profitability with Dividend Payout
				- Free Cash Flow	<ul style="list-style-type: none">- Negative relationship between Leverage and Dividend Payout
				- Size (log of market capitalization)	

				<ul style="list-style-type: none"> - Growth (growth rate of sales) - Leverage (debt/equity) - Business Risk (stock price Beta) - Profitability (ROE) 	
Al-Gharaibeh (2013)	Jordan	Full Adjustment Model (FAM) and Partial Adjustment Model (PAM)	<ul style="list-style-type: none"> - Dividend Payout Ratio 	<ul style="list-style-type: none"> - Institutional Ownership (% from 5%) - Managerial Ownership Dummy (for ownership above the sample mean) 	<ul style="list-style-type: none"> - Positive relationship between institutional ownership and dividend payout - Negative relationship between managerial ownership and dividend payout
Truong and Heaney (2007)	Multi-Country	Logit (for dividend decision), Lintner Tobit Model (for dividend payout ratio), 2SLS (for dividend payout ratio of paying firms only)	<ul style="list-style-type: none"> - Dividend Decision - Dividend to Net Income - Dividend to Net Sales 	<ul style="list-style-type: none"> - Insider Largest Blockholder Dummy - Institutional Largest Blockholder Dummy - Government Largest Blockholder Dummy - Ownership Concentration of the Largest Blockholder - Ownership Concentration Squared 	<ul style="list-style-type: none"> - U shaped relationship between Ownership Concentration and both Dividend Decision and Dividend Ratio - Negative relationship between Insider Blockholders and both Dividend Decision and Dividend Ratio - Positive relationship between Institutional Blockholders and Dividend Decision - Negative relationship between Institutional Blockholders and Dividend Ratio

Pindado et al. (2012)	Multi-Country	GMM	- Dividend to Assets	- Net Income	<ul style="list-style-type: none"> - Positive relationship between family firms and dividends - Positive relationship with no separation in voting and cash flow rights of family firms and dividends - Positive relationship between the presence of a non-family second blockholder and dividends
Short et al. (2002)	UK	Fixed Effects GLS for four dividend models (FAM, PAM, WM and ETM)	- Change in Dividends (total amount of dividends paid by the firm – last year dividend)	<ul style="list-style-type: none"> - Institutional Blockholder Dummy (from 5%) - Managerial Blockholder Dummy (from 5%) 	<ul style="list-style-type: none"> - Positive relationship between Institutional Blockholder and Dividends - Negative relationship between Managerial Blockholders and Dividends
Khan (2006)	UK	OLS and GMM	- Gross Dividends	<ul style="list-style-type: none"> - Top 5 Ownership (total ownership by the largest 5 blockholders) - Top 5 Ownership Squared (Top 5 X Top 5) - Insurance Blockholders % (from 5%) - Individual Blockholders % (from 5%) 	<ul style="list-style-type: none"> - Negative decreasing relationship between Top 5 Ownership and Dividend (inverse u shape but very low inflection point) - Positive relationship between Insurance Blockholders and Dividend - Negative relationship between Individual Blockholders and Dividend

Mancinelli and Ozkan (2006)	Italy	Tobit	<ul style="list-style-type: none"> - Dividend Payout Ratio - Dividend Yield 	<ul style="list-style-type: none"> - Voting Rights of Largest Shareholder - Voting Rights of all Blockholders (from 2%) - Multiple Blockholders Dummy (from 5%) - Voting Syndicate Dummy (shareholder agreements/representatives) 	<ul style="list-style-type: none"> - Negative relationship between the voting rights of the largest shareholder and dividend payout and yield - No significant relationship for all other variables (thus multiple blockholders do not monitor the largest shareholder, and might even collude with them)
Djebali and Belanès (2015)	France	OLS	<ul style="list-style-type: none"> - Dividend Per Share 	<ul style="list-style-type: none"> - Ownership Concentration (3 Largest Blockholders %) - Family Blockholders Dummy - Institutional Blockholder Dummy - Multiple Blockholders Dummy (from 10%) - Board Independence 	<ul style="list-style-type: none"> - Positive relationship between ownership concentration and dividend payout - Negative relationship between family blockholders and dividend payout - Positive relationship between institutional blockholders and dividend payout - Negative relationship between multiple blockholders and dividend payout - Positive relationship between board independence and dividend payout
Gonzalez et al. (2014)	Colombia	Tobit (for dividend ratio) and	<ul style="list-style-type: none"> - Dividend Ratio - Dividend Decision 	<ul style="list-style-type: none"> - Family CEO Dummy - Family Blockholder Dummy (when largest blockholder is a 	<ul style="list-style-type: none"> - Negative relationship between family ownership and dividend ratio and decision - Negative relationship between pyramidal family

		Probit (for dividend decision)		family)	control and dividend ratio
				- Pyramidal Family Control Dummy	- Positive relationship between majority family boards and dividend ratio and decision
				- Majority Family Board Dummy	
Bradford et al. (2013)	China	Tobit	- Dividend Yield - Dividend Payout Ratio	- Government Ownership Dummy - Control Chain (number of levels)	- Positive relationship between government blockholders and dividend yield and payout - Negative relationship between control chains and dividend yield
Chen et al. (2005)	Hong Kong	Fixed Effects	- Dividend Payout Ratio - Dividend Yield	- Family Ownership - thresholds of - 10%, - 10% - 35% - 35% - 100%	- No relationship between Family ownership and Dividend Payout or Yield
Abdullah et al. (2014)	Malaysia	Tobit	- Dividend Per Share - Dividend Payout Ratio	- Government Ownership % (of 8 different government agencies	- No relationship between Government Ownership and Dividend Per Share - Partly positive relationship between Government Ownership and Dividend Payout Ratio

4.3.1 Family Blockholders

The most common type of concentrated ownership around the world are Family blockholders (Singal & Singal, 2011; La Porta et al., 1999). Family control represents a distinctive type of ownership. Generally, family blockholders hold non-diversified portfolios, tend to be long-term oriented, and often hold senior managerial positions, thus placing them in a unique position to monitor and influence the firm (Shleifer & Vishny, 1997).

Furthermore, several studies have documented that family controlled firms outperform their non-family counterpart (Anderson & Reeb, 2003; van Essen, Carney, Gedajlovic, & Heugens, 2014; Villalonga & Amit, 2006). These findings support the argument that family members are well informed and maintain close attachment to the firm, resulting in decreased agency problems, and ultimately better performance (Villalonga & Amit, 2006).

Pindado et al. (2012) study the role of dividends as a governance mechanism in family firms from nine European countries. They found that family firms paid more dividends to alleviate minority shareholder expropriation concerns (Pindado et al., 2012). Setia-Atmaja et al. (2009) also find that family controlled firms in Australia employ higher dividend payouts compared to the non-family counterpart. Their findings indicated that family blockholders in Australia do not expropriate minority shareholders through dividends, and that family blockholders rely on dividends as a governance mechanism above others, such as board independence (Setia-Atmaja et al., 2009).

However, family blockholders are also expected to cause Principal-Principal agency problems. Uncontestable entrenched family owners might pursue non-value maximizing objectives, such as family political agendas, expropriate firm resources to the detriment of minority shareholders, or assign senior positions to under qualified family members (Anderson & Reeb, 2004; Setia-Atmaja et al., 2009). With an aim of expropriating firm resources, at the expense of minority shareholders, family blockholders are able to maximize the available resources for appropriation by not paying out dividends.

Djebali and Belanès (2015), Gugler (2003) and Gonzalez et al. (2014) studied the role of family blockholders on dividend policy in France, Austria and Colombia, respectively. In support of the expropriation argument, and P-P agency problems, they found that increased ownership by family blockholders negatively influence dividends. Therefore minority shareholders bear higher risks of expropriation under family controlled firms, in France, Austria and Colombia, by receiving lower dividends (Djebali & Belanès, 2015; Gugler, 2003; Gonzalez et al., 2014).

Furthermore, family blockholders tend to use control enhancing mechanisms in many parts of the world, such as dual class shares and/or pyramidal ownership structures (La Porta et al., 1999). Ultimately, family blockholders control firm decision making without bearing equal economic losses, through higher voting rights and lower cash-flow rights (Bebchuk et al., 2000). In that sense, Pindado et al. (2012) and Gonzalez et al. (2014) both find that family blockholders who use control enhancing mechanisms negatively influence

dividends. Pindado et al. (2012) find that family blockholders that have higher disproportionate ownership, through higher voting rights in dual class shares, negatively effects dividend payments in Europe. While Gonzalez et al. (2014) find that family ownership through pyramidal structures is associated with decreased dividends in Colombia.

Saudi Arabia is a country that is characterized by high level of authority and strong familial relationships in addition to a weak national governance system (Robertson et al., 2013; Ali, 2009; Bjerke & Al-Meer, 1993). In such a context, family blockholders are able to expropriate minority shareholders without the fear of being held liable, thus causing a principal principal agency problem. In order to increase the resources available for appropriation, family blockholders are expected to reduce dividend payments in Saudi Arabia. Therefore the first hypothesis is as follows:

H1. *There is a negative relationship between family ownership and dividends in Saudi Arabia.*

4.3.2 Royal Family Blockholders

The Kingdom of Saudi Arabia is a monarchy state that falls under the rule of the *Al Saud* Family (Long & Maisel, 2010). Having remained in power for over 80 years, members of the Saudi royal family generally enjoy superior political and relational advantages to other citizens of the country, similar to politically connected individuals in other countries (Faccio, 2010). Royal family members do not represent the government; rather they represent themselves as individuals with their own set of interests and motivations.

Firms that are politically connected are generally associated with several advantages over firms that aren't, such as ease of access to finance, lower tax rates and preferential treatment by the government in the form of lower regulatory oversight or financial bailout in times of distress (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2014; Claessens, Feijen, & Laeven, 2008; Faccio, Masulis, & McConnell, 2006; Faccio, 2006; Khwaja & Mian, 2005). These benefits are unique to politically connected firms, and thus puts them in a better position when compared to their non-politically connected counterparts.

Due to their lower risk of punishment, politically connected firms might represent higher tendencies to expropriate minority shareholders, (Bona-Sánchez et al., 2014; Khwaja & Mian, 2005). Researchers have shown that minority shareholders in China are less likely to be protected under the presence of a politically connected blockholder through less compliance with regulations (Berkman et al., 2010), by appointing under qualified board members (Fan et al., 2007), and even by holding high levels of cash for tunneling rather than being invested or paid to shareholders in the form of dividends (Liu et al., 2015).

Furthermore, politically connected firms generally have easier access to financing in the form of bank loans or government subsidies (Khwaja & Mian, 2005; Faccio et al., 2006; Claessens et al., 2008). Khwaja and Mian (2005) find that politically connected firms in Pakistan borrow 45% more than non politically connected firms, while at the same time, they have 50% higher rate of default risk. Likewise, Faccio et al. (2006) analyze the likelihood of government bailout from 35 countries and report that politically connected firms

significantly receive higher bailout than non politically connected firms. They also find that the performance of these politically connected firms is much worse at the time of and subsequent to the bailouts (Faccio et al., 2006).

Ultimately, politically connected owners, like royal family blockholders, are able to finance dividend payments through debt financing while still being able to appropriate firm resources. This enables them to signal their fair treatment to minority shareholders and firm resources without curtailing their private benefits extraction that causes principal principal agency problems. Accordingly, the second hypothesis is as follows:

H2. *There is positive relationship between royal family ownership and dividends in Saudi Arabia.*

4.3.3 Government Ownership

The presence of government ownership is fairly common in less developed countries, where previously fully government owned organizations that went through a privatization process become a public listed company with a majority ownership held by the government (Megginson & Netter, 2001; Dharwadkar et al., 2000). The government, or the state, normally maintains its ownership through various governmental agencies or institutions (Abdullah et al., 2014). Being a state that represents the highest level of authority in a country, governments normally are in a powerful position to influence the firm's ability to obtain financing (Bradford et al., 2013; Gul, 1999).

Firms under governmental ownership are regarded as a low default risk by financial institutions, thus are able to have easy access to external financing, which enables them to easily payout dividends (Gul, 1999; Abdullah et al., 2014).

Several empirical papers find support to this argument, as government ownership has been mainly found to positively influence dividend payouts. Gugler (2003), Abdullah et al. (2014), Bradford et al. (2013), Al-Kuwari (2009) and Osman and Mohammed (2010) have all found that dividends are positively related to governmental ownership in Austria, Malaysia, China, the GCC and Saudi Arabia, respectively. These results from different settings indicate that government ownership normally has the capacity to pay dividends to its shareholders.

Still, few studies didn't find any relationship between governmental ownership and dividend policy. Truong and Heaney (2007) and Al-Ajmi and Hussain (2011) both find no relationship between dividend policy and government ownership in a multi country sample and Saudi Arabia, respectively. Their argument is that government ownership and dividends might serve as complimentary governance mechanisms rather than substitutes (Al-Ajmi & Hussain, 2011).

The Saudi government normally maintain shares in strategic sectors, such as petrochemical and utility companies, thus their primary objective is control rather than investment. For example, the Saudi government owns 70% of SABIC (Saudi Basic Industries Corporation), which is the largest listed company in

terms of market capitalization, and 70% of Saudi Telecom (STC), which is the largest telephone service provider in the country (Tadawul, 2014).

Moreover, these firms with government ownership tend to be the best performers in the Saudi market, as besides them being utility companies or ones with no or minimal competition, they actually have little risk of going bankrupt, and have generally been the most sought after investments by the public, e.g. SABIC and STC (Almajid, 2008). By maintaining control over such sensitive organizations, the government doesn't intend to expropriate its resources and not payout dividends.

Saudi Arabia is ranked amongst the 20 highest GDP countries in the world (CIA, 2014), and its main income is from oil revenues, therefore, the Saudi government is not in a position to expropriate minority shareholders by not paying dividends. Moreover, the Saudi government is expected to have easier access to financing, therefore, will be able to constantly payout dividends to signal their intentions to improve the overall governance of the capital market in order to build investor confidence. Consequently, the third hypothesis is as follows:

H3. *There is a positive relationship between government ownership and dividends in Saudi Arabia.*

4.3.4 Corporate Ownership

Corporations invest in other firms in order to cultivate distinctive capabilities and technologies through potential synergies (Pfeffer & Salancik, 1978). Thus their main goal, in general, is not generating short term profits, as opposed to institutional ownership, rather is to develop synergies and/or ensure uninterrupted supply of resources (Sur et al., 2013).

Corporations have generally nurtured a unique set of knowledge and capabilities that enable them to better govern the acquired firm. Ultimately, corporate ownership is expected to positively influence the overall governance structure of the firm (Desender et al., 2013), which in turn should lead to higher dividend payouts.

Furthermore, corporate owners might signal to the general public their intention not to expropriate minority shareholders, by the means of tunneling firm resources, by paying out dividends (Bradford et al., 2013). As corporate owners are better capable of governing the firm, in addition to their intention to signal their just treatment to minority shareholders and firm resources, it is expected that corporate blockholders positively influence dividend payouts. Therefore, the fourth hypothesis is as follows:

H4. *There is a positive relationship between corporate ownership and dividends in Saudi Arabia.*

4.3.5 Managerial Ownership

The expected influence of managerial ownership on dividends differs greatly from that of other types of external blockholders. On one hand, the main agency problem [P-A] is expected to be alleviated through increased managerial ownership, which aligns the interests of managers with that of shareholders as they become owners themselves [incentive alignment]. On the other hand, at higher levels of managerial ownership, where the management power becomes uncontestable, managers might be inclined to pursue non value maximization policies, such as excessive perks, at the expense of shareholders [entrenchment effect] (Bennedsen & Nielsen, 2010; Claessens et al., 2002).

The incentive alignment and entrenchment effects of managerial ownership on the performance of US firms were first reported by Morck et al. (1988). They found that managerial 'incentive' alignment is achieved in low levels of ownership through improved firm performance, whereas at higher ownership levels, 'entrenchment' effects occur in the form of poorer performance. Their finding of non-linear relationship was further supported by several later studies (De Miguel, Pindado, & De La Torre, 2004; McConnell & Servaes, 1990; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

Similarly, Farinha (2003) argue that managerial ownership will follow an incentive and entrenchment effect towards dividend policy. His results show a U shaped relationship between the level of managerial ownership and dividend payout ratio in the UK. His results show that when managerial ownership falls below the entrenched level of 30%, which his data reports, dividend and

managerial ownership act as substitute governance mechanisms. As managerial ownership goes beyond that level, dividend policy becomes an essential governance mechanism for shareholders against managerial expropriation concerns (Farinha, 2003).

However, these findings reflect the case of a well developed country such as the Us and UK, thus it might not be a proper representation of other developing contexts, such as China or even Saudi Arabia, where minority shareholders face difficulty in protecting their interests (Claessens et al., 2002; Djankov et al., 2008; La Porta, Lopez-de-silanes, et al., 2000). In such contexts, while low levels of managerial ownership might lead to lower dividends due to incentive alignment, high ownership levels of entrenched managers will also cause lower dividends due to the incontestability of the entrenched manager by minority shareholders (Al-Gharaibeh, 2013; Kalcheva & Lins, 2007).

Furthermore, it is argued that managers prefer to retain earnings over dividend payments that reduces the free cash flow under their control (Jensen, 1986). Thus managerial ownership is expected to negatively effect dividend policy. Indeed several empirical studies confirm this relationship, as Jensen et al. (1992), Short et al. (2002) and Al-Gharaibeh (2013) all find that higher managerial ownership results in lower dividend payouts in the contexts of the US, UK and Jordan, respectively.

This study argues that whether it is the incentive effect or the entrenchment effect that influences managerial ownership towards dividend policy in Saudi

Arabia, the relationship would constantly remain negative. Either through substitution effects between dividends and managerial ownership due to incentive alignment at low levels of ownership, or through expropriation motives of increasing the free cash flow under managerial control by lowering dividends that entrenched managers desire. Accordingly, the fifth hypothesis is as follows:

H5. *There is a negative relationship between managerial ownership and dividends in Saudi Arabia.*

4.3.6 Multiple Blockholders

The presence of more than one blockholder in a firm is assumed to serve a vital governance role, as the second blockholder is able to limit the largest blockholder expropriation efforts (Pindado & Requejo, 2015; Attig et al., 2008). Researchers found that the presence of multiple blockholders is associated with significant valuation premium (Attig et al., 2008), and higher corporate risk taking (Mishra, 2011).

Generally, multiple large shareholders are expected to curb the largest blockholder from extracting private benefits of control at the expense of minority shareholders. Due to their ability to monitor both the largest blockholder and management, multiple blockholders limit minority shareholder expropriation concerns (Boubaker et al., 2014).

Similarly, Gugler and Yurtoglu (2003) find that the presence of a second large blockholder increases dividend payout, through alleviating the expropriation capacity of the largest blockholder by direct monitoring in Germany.

Furthermore, Pindado et al. (2012) finds that the presence of a non family second blockholder increases the dividend payouts of family firms in a sample that comprises nine European countries.

However, multiple large shareholders are also able to collude with each other and appropriate firm resources at the expense of minority shareholders (Cai et al., 2016). In that scenes, the presence of multiple blockholders leads to lower levels of dividend payouts, in order to maximize the resources available for expropriation. Djebali and Belanès (2015) Mancinelli and Ozkan (2006) both find support for this argument, as they found that the presence of multiple blockholders either negatively influenced dividend payment in France, or didn't influence it in Italy, respectively.

Lastly, the presence of multiple blockholders, of different types in the same company, is very common in the Saudi capital market, yet, minority shareholder rights are not reasonably protected (Quttainah & Paczkowski, 2012). In such a context, it would be expected that multiple blockholders would collude with each other and expropriate firm resources at the expense of minority shareholders resulting in a principal principal agency problem. Thus the presence of multiple blockholders would lead to lower dividend levels, in order to maximize the resources available for appropriation. Therefore, the sixth hypothesis is as follows:

H6. *There is a negative relationship between the presence of multiple blockholders and dividends in Saudi Arabia*

After analyzing the theoretical predictions and empirical evidence on the relationship between different types of blockholders and dividend policy in order to develop the hypotheses of the study, the next section will present the research methodology employed, which will cover the sample selection, variable measures and model specification of the study. The empirical investigation will help identify the actual role different blockholder types play on dividend policy in the Saudi Arabian public listed companies.

4.4 Research Methodology

4.4.1 Sample Selection

The sample of the study comprises all Saudi non-financial public listed companies on Tadawul, the Saudi stock exchange, for the six year period from 2008 to 2013. Tadawul holds 117 traded non-financial listed companies as of September 2014 (ZAWYA, 2014). Excluded from the sample are companies that the full data set variables were not available. A final sample (N) comprises of 619 firm year observations. Table 4.2 shows the total final sample size for each year. Data on dividend policy and firm level variables are manually collected from published annual reports, while ownership data is obtained from Reuters Thomson One Banker Database.

Table 4.2 Total Firm Samples per Year

Year	2008	2009	2010	2011	2012	2013	Total
N	89	97	102	105	114	112	619

The rationale behind the 2008 start year of the sample is that the disclosure of the ‘Board of Directors Report’ in the corporate annual report, which discloses the variables required for this study, only became mandatory in 2008 (CMA, 2010), thus data for previous years was impossible to obtain. Furthermore, 2013 was the last year of annual reports available when the data was collected for this research project. Finally, the exclusion of financial firms is justified by their unique business operation and strict legal requirements, as financial companies in Saudi Arabia have their exclusive governance code (CMA, 2010).

4.4.2 Variable Measures

4.4.2.1 Dependent Variable

This study investigates the influence of blockholders on the dividend policy of the firm. In that regard, two dividend measures serve as the dependent variable, namely dividend decisions (**DIVDUM**) and dividend to assets (**DIVSCL**). These two measures have been extensively used in the literature, as they reflect both the decision to payout dividends as well as the magnitude of dividend payment relative to firm size (Abdelsalam et al., 2008; Truong & Heaney, 2007; Al-Ajmi & Hussain, 2011; Al-Najjar & Hussainey, 2009; Pindado et al., 2012). **DIVDUM** is a binary variable that takes the value of 1 if the firm decides to pay dividend, and 0 otherwise. **DIVSCL** is measured as the total value of cash dividend distributed by the firm divided by firms' total assets.

4.4.2.2 Independent Variables

The independent variables represent the ownership structure of the firm. Several ownership variables are used in order to investigate how different blockholders influence dividend policy. The minimum disclosure level of ownership in Saudi Arabia is 5%. Therefore, blockholders of different types will be considered based on the 5% threshold⁷.

The first ownership variable is family ownership (**FMLOWN**). Family ownership represents the percentage ownership of family or individuals from

⁷ Different cutoff points, 5-20%, 20-50%, and >50%, have been examined in order to identify the level of ownership required to maintain influence. Which showed similar results to our combined findings of >5%.

total issued capital. Secondly, royal family ownership will be considered (**RYLOWN**). The percentage ownership of the Saudi ruling family members, *Al-Saud*, to total issued capital measures **RYLOWN**.

The third ownership variable measures the percentage of governmental ownership (**GOVOWN**). The government of Saudi Arabia directly holds shares in companies through three wholly-government-owned investment funds, namely, Public Investment Fund (PIF), Public Pension Agency (PPA) and General Organization for Social Insurance (GOSI) (ZAWYA, 2014). There are no private pension funds in Saudi Arabia thus citizens do not have other choices for retirement schemes. Moreover, only the government has the right to decide on the management and operation of these funds, therefore, it is more suitable to classify them as state ownership rather than institutional investors (Almajid, 2008). Due to the lack of competition and government appointment of the management team, these governmental agencies differ greatly in terms of their investment choices and overall governance from traditional institutional investors.

Fourthly, corporate ownership measures the percentage ownership held by a corporate entity (**CRPOWN**). While corporate ownership is common in Saudi Arabia, these corporations tend to be non-financial in nature. Although some corporations are privately held, which might represent a single family or individual investor, no data of ownership of these companies can be obtained. However, this study overlooked corporate ownership where the corporation's

registered name is of a family or individual and combined them with family owners instead.

The fifth ownership variable is managerial ownership (**EXECOWN**). **EXECOWN** represents the percentage ownership of the firm executive management to total issued capital. Executive management could be the CEO, CFO, COO or any member of the senior management team of the firm.

The presence of multiple large shareholders will be the final ownership variable (**MLS**). A binary/dummy variable that measures 1 if more than one blockholder is present in a single firm, and 0 otherwise. In the case of multiple blockholders from the same family, the study will consider them as a single block, rather than multiple blockholders, due to their similar interests and kinship relations that forms a familial coalition (Jara-Bertin et al., 2008). In the aim of measuring the contestability of other blockholders in preventing the controlling blockholders and/or management from expropriating minority shareholders, it is more reasonable to differentiate between multiple blockholders and clear blockholder coalitions.

4.4.2.3 Control Variables

This study will control for factors that are expected to be a determinant of dividend policy beside the ownership variables presented earlier. Research shows that certain firm characteristics might influence dividend policy for different reasons.

Firstly, as this study aims to investigate the governance role of dividends under blockholder control, it is important to control for other significant governance variables as well. Out of the various governance variables, the board of directors is considered as the most significant governance mechanism (Daily, Dalton & Cannella, 2003; Fama, 1980; Adams et al., 2010). The board of directors is a primary mechanism for minority shareholders to safeguard their interests (Quttainah & Paczkowski, 2012). One of the main board characteristics is the independent representation of its members (Ben-Amar et al., 2013; Jensen & Meckling, 1976). The level of board independence reflects the degree of minority shareholder representation in central corporate decision making (Anderson & Reeb, 2004; Setia-Atmaja, 2009). Board independence is measured as the total number of independent board members divided by the size of the board (**INED**).

Secondly, firm dividends is generally associated with future profitability (Jensen et al., 1992). In that sense, current firm performance reflects its future earnings, as well as its growth prospects (Jensen et al., 1992; Abdelsalam et al., 2008; Gul, 1999; Miller & Rock, 1985). Likewise, in the case of losses, firms are unable to payout dividends (Farinha, 2003). Therefore firm performance is a main determinant of dividend policy. Firm performance is measured through the accounting performance measure of return on assets (**ROA**).

Thirdly, the literature clearly indicates that corporate leverage influences its dividend policy (Setia-Atmaja et al., 2009; Jensen, 1986; Jensen et al., 1992). Debt is considered as a governance mechanism that reduces free cash flow available under managerial and/or controlling blockholder discretion, through the

payment of debt installments, thus resulting in lower requirement to pay dividends, acting as substitute governance mechanisms (Farinha, 2003; Jensen, 1986). Furthermore, obligatory debt installments will lower the firm's ability to payout dividends (Jensen & Meckling, 1976; McKnight & Weir, 2009). Thus leverage is expected to negatively influence dividend payout (Adjaoud & Ben-Amar, 2010). The leverage level is measured as total debt divided by total assets **(LEVERG)**.

Fourthly, firms with high levels of free cash flow face increased agency costs and managerial discretion due to the potential of private benefits extraction (Jensen, 1986; McKnight & Weir, 2009). Free cash flow might be expropriated by either the management and/or controlling blockholders in various ways, such as tunneling, investments in negative net present value projects, or excessive perquisites (Jensen, 1986; La Porta, Lopez-de-silanes, et al., 2000; Wang & Xiao, 2011). Consequently higher free cash flow should influence dividend policy, as minority shareholders would be better off by receiving dividends when the level of free cash flow is high (Adjaoud & Ben-Amar, 2010). In order to control for differences in firm size, free cash flow is measured as the level of cash holding divided by total assets **(FCF)** (Adjaoud & Ben-Amar, 2010).

Fifthly, the size of the firm not only reflects the level of firm complexity, it also represents a higher propensity for expropriation of resources (Jensen, 1986; Farinha, 2003). Furthermore, it is expected that large firms have easier access to external financing, and rely less on retained earnings to finance their projects, thus are able to pay dividends more easily (Adjaoud & Ben-Amar, 2010).

Consequently, it is expected that firm size would influence dividend policy. Firm size is measured using the natural logarithm of total assets (**FSIZE**). Firm sales is another measure of firm size used in the literature, however, several listed companies in our sample are recent start ups, thus don't have sales figures, therefore using total assets as the measure of size is more sensible.

Finally, the need to finance growth prospects is expected to influence dividend policy, as it is much cheaper to retain earnings rather than acquiring external financing sources (Jensen et al., 1992). Thus the level of firm maturity reflects its growth prospects, and consequently its dividend policy (Adjaoud & Ben-Amar, 2010). This study will consider the age of the firm to reflect the level of maturity that indicates the growth prospects of the firm. Firm age is measured as the natural logarithm of the number of years since the establishment of the firm (**LNAGE**).

4.4.3 Model Specification

Due to the unique nature of the dividend measures, which reflects the main dependent variables of the study, special care is required in order to avoid potential biases and inconsistent estimates driven by the values of its observations. Namely, the first measure of dividend is the decision to payout dividend by the firm (**DIVDUM**), which is constructed as a dummy variable that takes the value of 1 if the firm pays out any amount of dividends and 0 otherwise. This binary variable is best studied using a binary logistic regression (Logit) that takes into consideration the unique binary nature of the variable (Al-Najjar &

Hussainey, 2009; Abdelsalam et al., 2008; Truong & Heaney, 2007). Therefore the first model (1), below, represents logit regression.

Moreover, the second measure of dividend is the scaled cash dividend payment (**DIVSCL**), which equals the total amount of dividend paid divided by firm total assets. The choice behind using the scaled measure of dividend ratio is motivated by several reasons.

Firstly, the value of firm size, in terms of total assets, is much less volatile than other measures used in the literature, such as net income. Secondly, net income can be easily influenced by the accounting choices the firm follow, and is easily managed through different earnings management techniques. Finally, as this measure is heavily used in the literature, it enables us to compare our results with that of previous findings (López-Iturriaga & Santana-Martín, 2015; Pindado et al., 2012; Osman & Mohammed, 2010).

However, this measure suffers from a censoring problem, where firms that do not pay dividends have a value of 0, and which they constitute about 34.4% of the observations. Therefore using standard regression models might cause the results to be inconsistent and biased towards the zero observations (Mancinelli & Ozkan, 2006; Truong & Heaney, 2007; Al-Kuwari, 2009). Consequently, applying a tobit model that censors the zero observations, left censored, allows to adjust for such bias (Tobin, 1958). Consequently, the second model (2), below, represents tobit estimates.

To test the hypotheses developed that aims to answer the research question of the study, the following two models have been implemented:

$$(1) \quad \Pr (\text{DIVDUM}_{i,t} = 1) = \text{Logit} [\alpha_0 + \beta_1 \text{FMLOWN}_{i,t} + \beta_2 \text{RYLOWN}_{i,t} + \beta_3 \text{GOVOWN}_{i,t} + \beta_4 \text{CRPOWN}_{i,t} + \beta_5 \text{EXECOWN}_{i,t} + \beta_6 \text{MLS}_{i,t} + \beta_7 \text{INED}_{i,t} + \beta_8 \text{ROA}_{i,t} + \beta_9 \text{LEVERG}_{i,t} + \beta_{10} \text{FCF}_{i,t} + \beta_{11} \text{FSIZE}_{i,t} + \beta_{12} \text{LNAGE}_{i,t} + \varepsilon]$$

$$(2) \quad \text{DIVSCL}^*_{i,t} = \alpha_0 + \beta_1 \text{FMLOWN}_{i,t} + \beta_2 \text{RYLOWN}_{i,t} + \beta_3 \text{GOVOWN}_{i,t} + \beta_4 \text{CRPOWN}_{i,t} + \beta_5 \text{EXECOWN}_{i,t} + \beta_6 \text{MLS}_{i,t} + \beta_7 \text{INED}_{i,t} + \beta_8 \text{ROA}_{i,t} + \beta_9 \text{LEVERG}_{i,t} + \beta_{10} \text{FCF}_{i,t} + \beta_{11} \text{FSIZE}_{i,t} + \beta_{12} \text{LNAGE}_{i,t} + \varepsilon$$

where:

$$\text{DIVSCL}^*_{i,t} = \begin{cases} \text{DIVSCL}^*_{i,t} & \text{if } \text{DIVSCL} > 0 \\ 0 & \text{if } \text{DIVSCL} \leq 0 \end{cases}$$

α_0 :	Intercept
i :	Firm factor
t :	Year factor
β :	Regression coefficient
ε :	Error term

Table 4.3 presents the operationalization of the variables used in the study. The following section provides the results of the econometric models, as well as discussing the findings of these results.

Table 4.3 Operationalization of Variables

Variable		Measure
Dependent variables		
Dividend Decision	DIVDUM	A dummy variable that takes the value of 1 if the firm pays out any amount of Dividend and 0 otherwise
Dividend Scaled	DIVSCL	Total amount of Cash Dividend distributed divided by Total Assets
Independent variables		
Family Ownership	FMLOWN	The percentage of Family Ownership = Family Ownership over Total Issued Capital
Royal Family ownership	RYLOWN	The percentage of Royal Family Ownership = Royal Family Ownership over Total Issued Capital
Government Ownership	GOVOWN	The percentage of Government Ownership = Government Ownership over Total Issued Capital
Corporate Ownership	CRPOWN	The percentage of Ownership by other Corporate Entities = Corporate Ownership over Total Issued Capital
Managerial Ownership	EXECOWN	The percentage of Managerial Ownership = Executive Ownership over Total Issued Capital
Multiple Large Shareholders	MLS	The presence of more than one Blockholder in a single Firm (value of 1 if yes and 0 otherwise)
Control variables		
Board Independence	INED	The percentage of Independent Non-executive Directors sitting on the board = Number of Independents over Total Number of Board Members
Firm Performance	ROA	ROA = Net Income before tax divided by Total Assets
Firm leverage	LEVERG	Total Debt divided by Total Assets
Free Cash Flow	FCF	Level of Free Cash Flow = Cash Holdings over Total Assets
Firm Size	FSIZE	The natural log of Total Assets
Firm Age	LNAGE	The natural log of Firm Age in Years
Additional variables		
Lagged Dividend	LAGDIV	The total amount of Dividend paid by the firm in the previous year = Dividend Per Share times Number of Shares Outstanding for t-1

4.5 Results and Discussion

4.5.1 Descriptive Statistics

Table 4.4 provides information on the descriptive statistics of variables measured. The results show that roughly 65% of the observations in the sample paid dividends. While the average amount of dividend paid relative to firm size, in terms of total assets, is about 4.5%, and ranging from 0 to 43%.

The major ownership category is family ownership, where on average they hold 17% of the issued equity. Conversely, royal family ownership is the least manifested category, with average ownership of about 3%. Both government and corporate ownership on average hold about 9% of share capital, while managerial ownership is on average only 5%. The presence of multiple blockholders is a common theme, where more than one blockholder in a single company is found in around two thirds of the sample.

Additionally, the figures in Table 4.4 reflect that the variables are not normally distributed across the sample. The skewness of several variables fall beyond ± 1.96 , and the kurtosis mostly fall beyond ± 2 , which reflect the thresholds acceptable for normality (Hair et al., 2010). Therefore, utilizing OLS as an estimation method for our model is inappropriate, as it will produce biased estimates. Consequently, this study will employ binary logistic (Logit) and tobit (Tobit) techniques to test the model.

Table 4.4 Descriptive Statistics for Dependent, Independent and Control Variables

Variables	Min	Max	Std. Dev.	Mean	Median	Skewness	Kurtosis	N
DIVDUM	0	1	0.476	0.656	1	-0.656	1.431	619
DIVSCL	0	0.43	0.066	0.045	0.03	2.570	10.788	619
FMLOWN	0	0.725	0.217	0.173	0.0815	1.168	3.033	619
RYLOWN	0	0.95	0.117	0.028	0	5.828	41.623	619
GOVOWN	0	0.836	0.177	0.087	0	2.598	9.415	619
CRPOWN	0	0.75	0.161	0.089	0	1.983	6.254	619
EXECOWN	0	0.7	0.133	0.049	0	3.476	14.942	619
MLS	0	1	0.479	0.645	1	-0.604	1.365	619
INED	0	1	0.179	0.450	0.4	0.803	3.366	619
ROA	-0.672	0.494	0.105	0.069	0.06	-0.938	12.938	619
LEVERG	0.004	1.527	0.219	0.365	0.3359	0.700	4.136	619
FCF	0	0.668	0.085	0.062	0.0346	3.473	19.335	619
FSIZE	17.795	26.550	1.646	21.531	21.3971	0.566	3.389	619
AGE	0.693	4.078	0.841	2.688	2.9957	-0.311	2.052	619

Table 4.5 presents the correlation matrix for the dependent, independent and control variables. The results show that the correlation between the variables are comparatively low, mostly below 0.5, except for one observation which still lies below 0.7, thus no indication of a multicollinearity problem in the model (Gujarati, 2003). The highest correlation found is between firm performance (ROA) and both dividend decision (DIVDUM) and dividend payout (DIVSCL), of 0.474 and 0.689, respectively. This finding confirms the argument that firm performance is one of the main drivers of dividend policy (Farinha, 2003), and is similar to that reported in the literature (López-Iturriaga & Santana-Martín, 2015).

Additionally, moderately high correlation is found between family ownership (FMLOWN) and executive ownership (EXECOWN) of 0.468, which reflects that family owners maintain close control of the company and prefer to incentivize the management of their firms by increasing their level of ownership. Furthermore, moderately high correlation is also found between firm size (FSIZE) and leverage (LEVERG) of 0.431. This confirms the argument that the level of firm complexity reflects the easier access to finance due to the larger asset base that serves as a collateral for lenders.

Table 4.6 presents the variance inflation factors (VIF) for the variables, where all fall comfortably below the acceptable limit of 10 (Kutner et al., 2004). Thus further confirming that a severe multicollinearity problem is not present in our sample. The next section will discuss the results of the empirical model as presented in Tables 4.7 and 4.8.

Table 4.5 Pearson Correlation Matrix for Dependent and Independent Variables

Variables	DIVDUM	DIVSCL	FMLOWN	RYLOWN	GOVOWN	CRPOWN	EXECOWN	MLS	INED	ROA	LEVERG	FCF	FSIZE	AGE
DIVDUM	1													
DIVSCL	0.496	1												
FMLOWN	0.241	0.043	1											
RYLOWN	0.029	-0.064	-0.144	1										
GOVOWN	0.151	0.181	-0.280	-0.057	1									
CRPOWN	-0.161	0.021	-0.293	-0.060	-0.094	1								
EXECOWN	0.161	0.165	0.468	0.036	-0.143	-0.130	1							
MLS	0.208	0.148	-0.019	-0.009	0.292	0.309	-0.111	1						
INED	-0.062	-0.028	-0.206	0.014	-0.062	-0.261	-0.164	-0.230	1					
ROA	0.474	0.689	0.104	-0.138	0.109	0.005	0.216	0.135	-0.064	1				
LEVERG	-0.085	-0.256	0.132	0.047	-0.005	0.208	0.065	0.131	-0.249	-0.268	1			
FCF	0.025	0.201	-0.053	-0.078	-0.042	0.027	-0.065	-0.037	0.032	0.256	-0.170	1		
FSIZE	0.129	0.002	-0.134	0.109	0.490	0.303	-0.092	0.376	-0.308	-0.016	0.431	-0.145	1	
AGE	0.041	0.125	-0.391	-0.093	0.212	-0.242	-0.208	-0.134	0.258	0.026	-0.329	-0.045	-0.119	1

Table 4.6 Variance Inflation Factor (VIF) Values

Variable	VIF
FMLOWN	2.27
FSIZE	2.21
GOVOWN	1.97
CRPOWN	1.95
AGE	1.59
LEVERG	1.59
EXECOWN	1.44
MLS	1.39
ROA	1.34
INED	1.31
RYLOWN	1.21
FCF	1.15
Mean VIF	1.62

Table 4.7 Logistic Regression of Dividend Decision on Ownership Structure and Control Variables

	DIVDUM		
	Model 1	Model 2	Model 3
FMLOWN	5.799*** (2.95)		
RYLOWN	2.949 (0.99)		
GOVOWN	0.836 (0.32)		
CRPOWN	-0.289 (-0.01)		
EXECOWN	-1.920 (-0.72)		
MLS	1.170* (1.91)	1.024 (1.60)	0.629 (0.96)
OWNCNCTR		3.448** (2.00)	
OWN5TO20			3.438*** (2.50)
OWN20TO50			3.822*** (2.76)
OWNABV50			4.741*** (3.06)
INED	2.392 (1.59)	2.889* (1.89)	2.687* (1.71)
ROA	16.071*** (4.46)	14.835*** (4.08)	16.530*** (4.39)
LEVERG	-2.147 (-1.38)	-2.040 (-1.29)	-1.182 (-0.68)
FCF	-0.757 (-0.31)	-0.827 (-0.33)	-0.636 (-0.25)
FSIZE	1.178*** (3.21)	1.115*** (3.08)	1.042*** (3.00)
AGE	1.151** (2.39)	0.956** (1.97)	1.037** (2.12)
Constant	-30.424*** (-3.81)	-28.477*** (-3.66)	-28.886*** (-3.73)
N	619	619	619

Notes:

1. ***, ** and * denote p-value significance at 1%, 5%, and 10% level, respectively.
2. t-statistics are in parentheses.

Table 4.8 Tobit and GLS Regression of Dividend Ratio on Ownership Structure and Control Variables					
	DIVSCL				
	Model 1 (Tobit)	Model 2 (Tobit)	Model 3 (Tobit)	Model 4 (GLS)	Model 5 (GLS)
FMLOWN	0.102*** (4.08)			0.049*** (3.12)	0.074*** (3.95)
RYLOWN	0.078* (1.88)			0.045* (1.83)	0.066** (2.13)
GOVOWN	0.073** (2.33)			0.067*** (3.62)	0.102*** (4.44)
CRPOWN	0.077** (2.41)			0.078*** (4.01)	0.100*** (4.19)
EXECOWN	0.026 (0.85)			0.012 (0.57)	0.053** (2.12)
MLS	0.004 (0.43)	0.001 (0.18)	-0.003 (-0.35)	-0.003 (-0.60)	-0.004 (-0.62)
OWNCNCTR		0.094*** (4.44)			
OWN5TO20			0.058*** (3.63)		
OWN20TO50			0.073*** (4.40)		
OWNABV50			0.096*** (5.42)		
LAGDIV				0.015*** (11.54)	
INED	0.035* (1.82)	0.034* (1.77)	0.025 (1.37)	0.019 (1.56)	0.023* (1.74)
ROA	0.435*** (9.26)	0.434*** (9.30)	0.460*** (9.72)	0.134*** (6.64)	0.173*** (8.34)
LEVERG	-0.050** (-2.44)	-0.450** (-2.27)	-0.044** (-2.19)	-0.018 (-1.51)	-0.023* (-1.71)
FCF	0.022 (0.67)	0.015 (0.49)	0.023 (0.72)	0.042** (2.01)	0.029 (1.23)
FSIZE	0.003 (0.80)	0.002 (0.45)	0.003 (0.67)	-0.007*** (-2.66)	-0.006** (-2.06)
AGE	0.015*** (2.84)	0.013*** (2.73)	0.014*** (2.94)	0.005 (1.40)	0.012*** (3.01)
Constant	-0.192** (-2.01)	-0.150* (-1.74)	-1.970** (-2.37)	0.098* (1.85)	0.078 (1.19)
R-sq				0.720	0.553
N	619	619	619	619	619
Left Censored	220	220	220		
Uncensored	399	399	399		

Notes: 1. ***, ** and * denote p-value significance at 1%, 5%, and 10% level, respectively. 2. t-statistics are in parentheses.

4.5.2 Discussion of Results

Table 4.7 reports the panel data logistic regression (Logit) of dividend decision (DIVDUM) on ownership structure and control variables, while Table 4.8 reports the panel data tobit regression (Tobit) of scaled dividend payout (DIVSCL) on ownership structure and control variables. Model 1, which is the primary model of the study, reports the independent variables of ownership, for the different types of blockholders, along with the firm specific control variables on dividend decision. While models 2, 3, 4 and 5 provide additional tests on dividend payout, which will be discussed in the subsequent section.

The results show that family blockholders (**FMLOWN**) are positively and significantly related to both dividend decision (DIVDUM) and dividend payout (DIVSCL) at the 1% level. This result is opposite to the first hypotheses (H1), which expects family blockholders to negatively influence dividends in order to maximize their private benefits of control, thus the hypothesis is rejected. These results provide evidence that family blockholders in Saudi Arabia do not intend to expropriate minority shareholders by increasing the free cash flow available for appropriation. It is important for family blockholders to provide such positive dividend strategy in order to sustain their legitimacy for minority investors; after all family blockholders are the most type of blockholders present in the Saudi market. Two explanations could be linked to this positive relationship.

On the one hand, under the agency theory explanation, family blockholders might view dividend payment as a viable governance mechanism that disciplines the management. As family investors tend to be under diversified, it is important for them to protect their invested wealth from managerial expropriation. In that sense, dividends act as a governance mechanism that limits the level of free cash flow under managerial disposal (Jensen, 1986), and/or increases the level of monitoring by the external capital market (Easterbrook, 1984). This rationale is supported by the results of Setia-Atmaja et al. (2009), who report that family ownership positively influenced dividends in Australia. They report that family blockholders were found to prefer dividend payments over other governance mechanisms, such as board independence, as a managerial disciplining device in the Australian context (Setia-Atmaja et al., 2009).

On the other hand, under the stakeholder and signaling theories, family blockholders might signal to minority shareholders and other stakeholders their intention of not expropriating firm resources by obtaining private benefits of control. By signaling such good commitments, family blockholders aim at gaining investors' trust in acquiring firm shares (Setia-Atmaja, 2009). This rationale is supported by the findings of Pindado et al. (2012), who report that family ownership positively influenced dividends in nine European countries. Their results show that family blockholders pay higher dividends in order to alleviate minority shareholder expropriation concerns (Pindado et al., 2012). Therefore, under the agency, stakeholder and signaling explanations, the results of increased dividends show that family blockholders tend not to create expropriation concerns for minority shareholders in the Saudi Arabian context.

These results might reflect the role that Islamic teachings play in shaping the behavior of family blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values (Muneeza & Hassan, 2014; Lewis, 2005; Rizk, 2008a). As a result, family blockholders positively influence the governance of Saudi public listed companies by reducing the free cash flow available for insider appropriation, therefore acting in the best interest of the various stakeholders.

Moreover, royal family blockholders (**RYLOWN**) are found to be insignificantly related to dividend decision (DIVDUM), but positively and significantly related to dividend payout (DIVSCL) at the 10% level. This finding partly supports the second hypothesis (H2), which expects that royal family blockholders would positively influence dividend policy with their easier access to financing, while still being able to appropriate firm resources if desired.

This result shows that royal family blockholders do not influence the decision to pay dividend, however, when the firm decides to payout dividends, royal family blockholders push these dividends higher. These results must be interpreted with caution. While royal family blockholders are able to expropriate minority shareholders and still payout higher dividends, however, this might not be the case as royal family blockholders might actually aim at improving the governance of the firm and signal these intentions to the general public by increasing the level of dividends paid.

Furthermore, the result of no significant relationship between dividend decision and royal family blockholders might reflect that royal family blockholders do not care about dividend decisions, as they are able to extract private benefits of control in all circumstances. However, this result might also suggest that royal family blockholders do not pressure firms to payout dividends. As royal family blockholders in Saudi Arabia normally own large blocks, as well as holding the chairman of the board position, they might leave the decision, of whether to pay dividends or retain earnings for operational and growth expenses, to be decided by the executive team and the board.

Similarly, government ownership (**GOVOWN**) shows an insignificant relationship with dividend decision (DIVDUM), but positive and significant relationship with dividend payout (DIVSCL) at the 5% level. This finding partly supports the third hypothesis (H3), which expects that government ownership would lead to higher dividends, due to the easier access to financing, thus the hypothesis is accepted. This result shows that government ownership does not affect whether to pay dividends or not, however, when the firm decides to payout dividends, firms that have the government as a blockholder tend to distribute higher dividends.

The finding that government ownership positively influences dividend ratio corroborates that of most previous studies which found that dividends are positively related to governmental ownership in different contexts such as Austria (Gugler, 2003), China (Bradford et al., 2013), Malaysia (Abdullah et al., 2014), the Arab states of the GCC (Al-Kuwari, 2009) and even Saudi Arabia

(Osman & Mohammed, 2010) mainly due to the easier access to financing and lower default risk government owned firms enjoy.

Another explanation of the positive influence of government ownership on the dividend payout might be the intention of the Saudi government to act as a example of good practice and assist in the improvement of the market's corporate governance (Bukhari, 2014). Whether the Saudi government's positive influence on dividend payouts is motivated by the agency theory of free cash flow that governs the management, or to signal to the market its treatment of firm resources, it is generally in the best interest of minority shareholders.

Furthermore, the non-significant relationship between government ownership and dividend decision might indicate that government ownership and dividends act as complimentary governance mechanisms. Thus government blockholders do not demand dividend distribution, rather they use dividends as a complimentary governance mechanism to their potent monitoring capabilities. This finding supports that of Truong and Heaney (2007) and Al-Ajmi and Hussain (2011), who both find no relationship between dividend policy and government ownership in a multi country sample and Saudi Arabia, respectively, which reflects the complementarity between these two mechanisms.

Likewise, corporate ownership (**CRPOWN**) is also found to be insignificantly related to dividend decision (DIVDUM), but positively and significantly related to dividend payout (DIVSCL) at the 5% level. This finding partly supports the fourth hypothesis (H4), which expects that corporate ownership would lead to higher

dividends, due to their capability to better govern the firm, thus the hypothesis is accepted. This result shows that corporate ownership does not influence the decision to pay dividend, however, when the firm decides to payout dividends, corporate blockholders tend to increase the level of dividends paid, relative to firm size.

The results show that corporate owners in Saudi Arabia tend to signal to minority shareholders and other stakeholders their intention not to expropriate firm resources, which can be easily achieved through inter-corporate tunneling (Bradford et al., 2013), by increasing the amount of dividends paid. Moreover, the non-significant relationship between corporate ownership and dividend decision could imply that corporate ownership and dividends act as complimentary governance mechanisms. As corporate owners are better capable of governing the firm, through their developed knowledge and expertise, they are well suited to act as a complimentary governance mechanism to dividend decision.

Additionally, managerial ownership (**EXECOWN**) is found to be insignificantly related to both dividend decision (**DIVDUM**) and dividend payout (**DIVSCL**). Therefore, the fifth hypothesis (H5), which expects a negative relationship between managerial ownership and dividends, which reflects both the incentive and entrenchment effects, is rejected. The finding of no significant relationship can be viewed as both dividend payments and managerial ownership act as complimentary governance mechanisms, rather than substitute mechanisms

under the incentive alignment hypothesis or the expropriation motivations under entrenched levels of ownership.

However, this result could also indicate that managers in the Saudi context do not enjoy comparable power, in terms of decision making, to that of outside blockholders. As all other types of external blockholders, namely: family, royal family, government and corporate blockholders, from the preceding discussion where found to influence dividend policy, in one way or another. Accordingly, managers in Saudi Arabia might be encouraged by external blockholders through means of increasing their level of ownership, in order to align their interests with that of shareholders, without giving them full control over key decision making. This also supports the notion that the agency problem in countries with concentrated ownership, such as Saudi Arabia, is the one between controlling and minority shareholders [P-P], rather than the one between management and shareholders [P-A] (Young et al., 2008). Previous studies by Abdelsalam et al. (2008) and Truong and Heaney (2007) reported similar results, where managerial ownership did not influence dividend policy.

Furthermore, the presence of multiple blockholders (**MLS**) is found to be positively and significantly related to dividend decision (DIVDUM) at the 10% level, but insignificantly related to dividend payout (DIVSCL). This finding is opposite to the last hypothesis (H6), which assumes that multiple blockholders would collude to expropriate minority shareholders by reducing dividend payments, in order to maximize the resources available for appropriation, thus the hypothesis is rejected.

The results indicate that multiple blockholders in Saudi Arabia act in the best interest of the various stakeholders, including minority shareholders, by means of minimizing the free cash flow available for expropriation, in the form of higher decisions to payout dividends. Due to their ability to monitor both the largest blockholder and management, multiple blockholders limit minority shareholder expropriation concerns (Boubaker et al., 2014). Similar results have been reported in the literature, such as Gugler and Yurtoglu (2003), who finds that the presence of a second large blockholder increases dividend payout in Germany. Their result of increased dividends is achieved through direct monitoring by the second largest blockholders, which in turn alleviates the expropriation capacity of the largest blockholder (Gugler & Yurtoglu, 2003).

Likewise, Pindado et al. (2012) finds that the presence of a non family second blockholder increases the dividend payouts of family firms in a sample from Europe. These results reveal that the non family second blockholders are able to minimize the appropriation ability of the controlling family blockholder, and thus protects minority shareholders from being expropriated (Pindado et al., 2012).

Moreover, the non-significant relationship between the presence of multiple blockholders and dividend payout rate could be explained by two competing arguments. On the one hand, the non-significant relationship could imply that both multiple blockholders and dividends act as complimentary governance mechanisms, in which both protect the interests of minority shareholders. On the

other hand, the non-significant relationship could also reflect that multiple blockholders in Saudi Arabia are not able to contest the demands of the controlling shareholders, such as influencing the governance of the firm through the payment of higher dividends, and thus multiple blockholders become an ineffective governance mechanism. Mancinelli and Ozkan (2006) reported similar findings, where multiple blockholders had no influence on the dividend policy in Italy.

Several control variables show significant relationship with dividend policy. Firstly, the level of board independence (**INED**) is found to be positively and significantly related to dividend payout (DIVSCL) at the 10% level. This reflects that better governed firms, in terms of minority shareholder representation through independent directors, payout higher dividends. Therefore, minority shareholder interests are further protected when the overall governance of the firm is stronger.

Secondly, firm performance (**ROA**) is found to be positively and significantly related to both dividend decision (DIVDUM) and dividend payout (DIVSCL) at the 1% level. This strong positive relationship confirms that firm profitability, which signals future prospects by reflecting the state of firm performance, is a key determinant of dividend policy. More profitable firms are also able to raise the funds required to distribute dividends.

Thirdly, firm leverage (**LEVERG**) is found to be negatively and significantly related to dividend payout (DIVSCL) at the 5% level. This finding supports the

argument that debt reduces the free cash flow and acts as a substitute governance mechanism to dividends. Leverage obliges the firm to repay continuous debt installments, which in turn protects minority shareholder interests by reducing the free cash flow available for appropriation, as well as placing the firm under scrutiny by the creditor.

Fourthly, firm size (**FSIZE**) shows significant relationship at the 1% level with dividend decision (DIVDUM), where the relationship is positive. Thus confirming that larger firms enjoy easier access to finance, due to their higher asset base that serves as collateral, which enables them to pay dividends more often. While larger firms provide higher propensity to appropriate firm resources, the results reveal that in Saudi Arabia, minority shareholders are not being expropriated in large firms.

Finally, in support to the growth prospects argument, firm age (**AGE**) is found to be positively and significantly related to both dividend decision (DIVDUM) and dividend payout (DIVSCL) at the 1% level. As firms mature overtime, their financing requirements for growth declines. These financing requirements in young firms are best financed through retained earnings rather than being paid out in the form of dividends. Thus older, more mature firms have higher levels of earnings that can be easily paid out as dividends. These results imply that minority shareholders' interests are protected in the Saudi context, where firms with low growth prospects distribute higher and more frequent dividends rather than appropriating firm profit, in the form of excessive perquisite or tunneling, for example.

4.5.3 Robustness Checks

In order to further examine the robustness of the results, several models have been employed. Models 2 and 3 in Table 4.7 and Table 4.8 examine the role of ownership concentration on dividend decision (DIVDUM) and dividend payout (DIVSCL), respectively, regardless of the type of blockholder. Models 2 measure the entire combined ownership concentration of over 5% (**OWNCNCTR**) as the independent variable. Model 3 divides the level of concentration into three groups; comprising a dummy variable that equals 1 if the total ownership concentration in a firm falls under each threshold of 5% to 20% (**OWN5TO20**), 20% to 50% (**OWN20TO50**) and over 50% (**OWNABV50**), and 0 otherwise. The motivation behind this measurement is to examine whether blockholders of different levels of ownership influence dividend policy differently or not. Different results for different levels of ownership could signal the incentive and entrenchment effects previously documented in the literature (De Miguel et al., 2004; McConnell & Servaes, 1990; Morck et al., 1988; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

The results of Models 2 demonstrate that ownership concentration (**OWNCNCTR**) is positively and significantly associated with dividend decision (DIVDUM) and dividend payout (DIVSCL) at the 5% and 1% levels, respectively. This result further supports the previous findings, where all blockholder types in Saudi Arabia with a significant relationship to dividend policy are found to be positive; namely family, royal family, government and corporate blockholders. Therefore, blockholders in the Saudi context, of any type, do not tend to

expropriate minority shareholders; rather they positively influence dividend policy instead of using internal funds to extract private benefits of control.

Additionally, Model 3 reveals that the blockholders' positive influence on dividend policy is similar at the three different concentration thresholds. All the three thresholds are found to be positively and significantly related to both dividend decision (DIVDUM) and dividend payout (DIVSCL) at the 1% level. Therefore, no matter what level of ownership the blockholder retains, above 5%, the influence on the dividend policy of Saudi firms is similar. Hence, blockholders of any level in the Saudi market tend to possess equal power to influence decisions on the dividend policy, and ultimately, the overall governance of the firm. This could reflect the signaling by these blockholders towards their good treatment of minority shareholder through higher dividend payout policies.

Models 4 and 5 in table 4.7 utilize a different estimation technique, namely generalized least squares regression (GLS), where model 4 includes lagged dividend as a control variable (**LAGDIV**). Lagged dividend is considered a key determinant of future dividend policy, as prior research show that firms aim to maintain stable dividend payments (Adjaoud & Ben-Amar, 2010; Lintner, 1956). Thus, it is important to investigate whether the results change with the inclusion of lagged dividend. Still, the results of the GLS regression in Models 4 and 5 report similar results, in terms of direction and significance, between the dividend payout (DIVSCL) and the independent and control variables, to that reported in the Tobit model.

Yet, three additional remarks can be extracted from these results. Firstly, the lagged dividend measure (**LAGDIV**) showed positive and significant relationship with the dividend ratio (DIVSCL) at the 1% level. This confirms the notion that firms tend to maintain sticky dividend policies, however, the inclusion of this measure did not affect the results of the study.

Secondly, in Model 5, managerial ownership (**EXECOWN**) is, for the first time, found to be significantly related to dividend ratio (DIVSCL) at the 5% level. Therefore, managerial blockholders in Saudi Arabia payout higher dividends in the best interest of minority shareholders, instead of utilizing these funds for private benefit extraction. This result further supports the previous findings of the different blockholder types in the Saudi market, which all did not aspire to expropriate minority shareholders.

Thirdly, in both Models 4 and 5, firm size (**FSIZE**) show negative and significant relationship with dividend ratio (DIVSCL) at the 1% and 5% levels, respectively. While this result is opposite of that found in the firm size (**FSIZE**) and dividend decision (DIVDUM) relationship, it is not surprisingly so due to the nature of these variables. Our main dividend ratio variable (DIVSCL) is a scaled measure of dividend payout in terms of firm total assets. And the firm size measure (**FSIZE**) is measured as the natural log of total assets. Therefore, the larger the firm size in terms of total assets, realistically, the smaller the amount of scaled dividend payment would turn out to be. Therefore, it is not surprising to find that firm size is negatively related to dividend ratio in our study.

Corporate governance research has recently illustrated the problem of endogeneity concerning dividend policy and ownership structure variables (Benjamin et al., 2015; Chen et al., 2005; Gippel et al., 2015; Wellalage & Locke, 2015). While there are several tools that try to limit the endogeneity problem, there is no solution that can eliminate it completely (Gippel et al., 2015). Out of the various methods used in the literature, regressions that utilize a generalised method of moments [GMM] are largely recommended (Lee et al., 2015; Keasey et al., 2015; Pindado et al., 2012).

GMM is a viable solution to the endogeneity problem, however, as GMM relies on lagged values, and as the main independent variables of this study, which are ownership structure, tend to be stable over time, GMM becomes unsuitable for such type of data (Andres, 2011; Goergen & Renneboog, 2001). Additionally, our main dependent variables, which are dividend ratio (DIVSCL) and dividend decision (DIVDUM), are either a censored or binary variables, in which a censoring problem that leads to biased estimates towards the zeros might occur. Thus using Tobit and Logit as the main models of the study, respectively, will prevent such censoring problem (Bradford et al., 2013; Barclay et al., 2009; Al-Najjar & Kilincarslan, 2016).

The following section provides the concluding remarks of this chapter, which includes the main findings and contribution to knowledge.

4.6 Conclusion

This chapter investigated the role of blockholders on the dividend policy of Saudi public listed companies. The level of dividend payout under different types of blockholders reflects the degree of minority shareholder's concerns regarding the expropriation of firm resources by controlling blockholders. Lower dividend payments indicate higher propensity for private benefit extraction by blockholders due to the increased free cash flow available for appropriation.

A Logit and Tobit models were used to test the relationship between different blockholder types and both dividend decisions (DIVDUM) and dividend ratio (DIVSCL), respectively, for 117 non-financial listed companies in Saudi Arabia from 2008-2013. After controlling for conventional determinants of dividends, the results of 619 firm year observations show that minority shareholder interests are mostly protected under control by all types of blockholders in the context of Saudi Arabia.

The findings of the study reveal that blockholders do not reduce dividends in order to maximize the resources available for private benefit extraction in Saudi Arabia. Rather, as Table 4.9 shows, most blockholders positively influence dividend policy, namely family, royal family, government, corporate and multiple blockholders, either to signal their fair treatment to minority shareholders, or to utilize dividends as a governance mechanism that reduces the free cash flow available under insider discretion.

Table 4.9 Summary of Hypotheses and Empirical Findings of Blockholder and Dividend Policy Relationship

Blockholder Type	Expected		Findings	
	Dividend Decision	Dividend Ratio	Dividend Decision	Dividend Ratio
Family	-	-	+	+
Royal Family	+	+	no	+
Government	+	+	no	+
Corporate	+	+	no	+
Managerial	-	-	no	no
MLS	-	-	+	no

These results might reflect the role that Islamic teachings play in shaping the behavior of blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values (Muneeza & Hassan, 2014; Lewis, 2005). The Islamic ethical system promotes the protection of the rights of the various stakeholders and urges humans to act as stewards entrusted in achieving continuity and societal welfare (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015). The strong influence of the Islamic religion on Saudi Arabia is far reaching, and might well demonstrate the favorable conduct of blockholders (Bukhari, 2014), who protect the interests of all shareholders as well as other stakeholders by positively influencing the dividend policy of the firm.

The results might further reflect the institutional legitimacy of minority shareholder protection that controlling blockholders are pressured to cope with in order to gain the trust of the general public to invest in the firm's stocks. The highly concentrated ownership of the Saudi capital market, as well as the powerful position controlling families and the government enjoy, creates a situation where the expropriation of minority shareholders remain a huge concern, and therefore it becomes crucial for blockholders to signal their intentions of protecting minority shareholders and serve the best interest of the firm and its stakeholders instead by positively influencing dividend policy, for example (Pindado et al., 2012; Edmans, 2014).

From a theoretical standpoint, the findings of the study indicate that blockholders of different types in Saudi Arabia tend to reduce the agency problem inherent in public listed companies under their presence and act in the best interest of other stakeholders, including minority shareholders by improving dividend policy. These findings might offer assurance to different stakeholders that blockholder presence in Saudi Arabia is not detrimental to the firm, and that the interests of current and potential shareholders are protected.

This study contributes to the literature in several ways. Firstly, this study provides one of the earliest empirical investigations on the blockholder and dividend relationship in a developing context, namely Saudi Arabia, while taking into consideration the different types of blockholders and their respective level of ownership. Saudi Arabia reflects a unique institutional setting that differs greatly from that of Anglo-American (Khan, 2006; Short et al., 2002), European

(Djebali & Belanès, 2015; Mancinelli & Ozkan, 2006), Latin (Gonzalez et al., 2014) or even East Asian contexts (Abdullah et al., 2014; Chen et al., 2005; Bradford et al., 2013), which have been investigated in the literature.

Secondly, this study combines all the types of blockholders present in the Saudi market, which includes a unique type of royal family members, which are similar to politically connected blockholders. Studies on the ownership and dividend relationship generally focus on a single blockholder type, such as family (Chen et al., 2005; Gonzalez et al., 2014; Pindado et al., 2012), institutional (Abdelsalam et al., 2008; Al-Gharaibeh, 2013; Short et al., 2002), or government (Abdullah et al., 2014; Bradford et al., 2013; Al-Ajmi & Hussain, 2011; Osman & Mohammed, 2010; Al-Kuwari, 2009). Few studies do incorporate two blockholder types in analysing the ownership dividend relationship (Truong & Heaney, 2007; Djebali & Belanès, 2015), however, no study included family and government blockholders in a single study, let alone all these blockholder types together.

Finally, this study increases our understanding of the dynamics of the Saudi capital market, which is largely understudied, by examining the principal principal agency problem [P-P] between controlling and minority shareholders. This is achieved by studying the dividend policy and ownership structure relationship, which reflects the level of expropriation concerns minority shareholders encounter under the presence of controlling blockholders, who are able to maximize the private benefit extraction by minimizing dividend payouts.

Chapter Five

Blockholders and Audit Quality

5.1 Introduction

With the aim of investigating the role of blockholders in the governance of Saudi firms, this chapter studies the level of audit quality under the control of different blockholder types present in the Saudi capital market. Audit quality plays a significant role in the assurance of the fairness in firm's financial reports (DeFond & Zhang, 2014). Accordingly, audit quality serves a primary governance role that helps protect minority shareholder interests by reducing information asymmetry through improved financial reporting (Cohen et al., 2002). Ultimately, the audit quality level represents the severity of the agency problem between controlling insiders and minority shareholders.

5.1.1 Research Motivation

The modern form of public incorporation, which is characterized by the separation in ownership and control rights, is at the heart of the corporate governance realm. One of the main drivers of the agency problem in modern corporations is the information asymmetry that exists between firm's insiders, being the management and/or controlling blockholders, and firm's outsiders, being the dispersed minority shareholders and other stakeholders (Fama & Jensen, 1983; Jensen & Meckling, 1976). The interests of controlling insiders, whether economical or political, might greatly differ from that of outsiders, and there is high information asymmetry that exists between the two.

Since self interested insiders know more about the company and the business they operate, the risk of them engaging in opportunistic behavior increases. The presence of controlling insiders poses the threat of appropriating firm resources at the expense of minority shareholders. Whereas minority shareholders rely on publicly disclosed information in order to make their investment decisions; in the form of annual reports and financial statements, controlling insiders might intend to withhold information which might indicate any act of appropriation (Healy & Palepu, 2001). Ultimately, the quality of disclosed information becomes crucial for safeguarding the interests of minority shareholders and other external stakeholders.

Audit quality serves an essential role in reinforcing assurance on the integrity of the firm's financial reports. Audit quality, which reflects the quality of disclosed information, can be achieved in two ways (DeFond & Zhang, 2014). Firstly, by increasing external oversight over the auditing process of the firm, such as through qualified independent external auditors (DeAngelo, 1981; Lennox, 1999; Mansi et al., 2004). Secondly, by improving reporting quality through improved internal audit structures, such as the audit committee (Woidtke & Yeh, 2013; Al-Ajmi, 2009; Abernathy et al., 2013).

All listed firms undertake an annual audit, which is conducted by an independent, competent and qualified auditor, in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material matters (Hawkamah & IFC, 2008). External auditors

serve an essential role in reinforcing assurance in the quality of the financial reports by providing independent checks on the financial and accounting statements of the firm (DeAngelo, 1981; Lin & Liu, 2009; Mansi et al., 2004).

With regards to the external auditor, audit quality refers to the ability of the audit firm to detect misstatements in the firms' financials, and the willingness to report these misstatements if uncovered (Lin & Liu, 2009; DeAngelo, 1981). Therefore, the quality of the auditing task is important in safeguarding shareholder interests by improving accounting transparency, which minimizes information asymmetry between the parties (Liu et al., 2016).

Moreover, the extant literature emphasized the benefits of having a large expert auditor with long standing history, as these auditors possess advance knowledge and skills, which enables them to better monitor the firm and achieve higher levels of expertise in performing the auditing task (Lennox, 1999; Francis, 2004; Mansi et al., 2004). Additionally, these large auditors are more independent, rely less on a single client, and have more at stake in the event of reputational damage caused by negligence or colluding behavior, when compared to small auditors (Mansi et al., 2004; DeAngelo, 1981; Francis, 2004).

The globally renowned international auditors, which are generally referred to as the 'Big Four' (KPMG, Ernst & Young, PricewaterhouseCoopers and Deloitte), reflect such size and standing, and are generally associated with higher quality audits (Francis, 2004; Mansi et al., 2004; Moizer, 1997). These so called 'Big Four' all operate in the Saudi market and provide auditing services to numerous

public listed companies, where on average 68.5% of the audit market share from all industries in the Saudi market is audited by one of the Big Four (Slamen et al., 2014).

On the other hand, audit quality might also be achieved by improving the internal audit function of the firm (DeFond & Zhang, 2014). Audit committees have gained significant status within the internal audit function after the US Sarbanes-Oxley [SOX] act of 2002 gave specific guidelines on enhancing the power and responsibility of the audit committee over firm reporting process (Naiker & Sharma, 2009; Malik, 2014). The establishment of the audit committee is based on the protection of shareholder rights (Al-Twaijry et al., 2004).

In Saudi public listed firms, the audit committee is at the apex of internal audit, where all listed firms are required to have an established audit committee (Al-Twaijry et al., 2004). Audit committees are responsible for supervising the internal audit process, nominating the appointment, dismissal and remuneration of the external auditor, and reviewing the internal audit reports, interim and annual financial statements and the accounting policies employed (CMA, 2010).

Accordingly, the audit committee serves a vital role which links the external auditors, the internal audit and the board (DeFond & Zhang, 2014; Woidtke & Yeh, 2013). Two audit committee characteristics are generally attributed to its effectiveness; namely the independence and financial expertise of its members (DeFond & Zhang, 2014; Carcello & Neal, 2003; Chen & Zhou, 2007).

Audit committees with higher levels of independence and financial expertise are able to serve their required role more effectively and are generally associated with improved audit reporting quality (Woidtke & Yeh, 2013; Abernathy et al., 2013; Cohen et al., 2002; Krishnan, 2005), improved credibility of financial statements (Klein & Zur, 2009; Al-Ajmi, 2009; Carcello & Neal, 2003), and increased demand for quality external auditors (Chen & Zhou, 2007; Ho & Kang, 2013; DeFond & Zhang, 2014).

Ultimately, audit quality, as reflected by the choice of external auditor and the characteristics of the audit committee, is a vital governance mechanism that maintains the credibility and integrity of financial statements from manipulation that controlling insiders, either management or blockholders, might engage in (Cohen et al., 2002).

5.1.2 Research Context

There are several motivations behind choosing Saudi Arabia as the context of this study. Saudi Arabia is an emerging/developing country that plays an important role in the global economy. It is the largest producer of crude oil and has the largest proven oil reserves in the world (CIA, 2014). Additionally, Saudi Arabia showed high economic and political stability in a time of global economic crises and regional turmoil; the credit crunch and the Arab Spring (Viñals & Ahmed, 2012; Jones, 2013).

Moreover, Saudi Arabia presents a unique setting, where religious, cultural and social factors, that are similar to those of other Arab and Islamic nations, play an important role in the day to day lives of the society. Islam is the only legal

religion of Saudi Arabia, and Islamic law, referred to as *Sharia*, serves as its constitution (CIA, 2014).

Saudi Arabia is characterized by the wide presence of blockholders, who control more than two thirds of Saudi listed companies (Quttainah & Paczkowski, 2012; Santos, 2015). In dispersed ownership structures, the main agency problem is between shareholders and managers [Principal-Agent or simply P-A]. However, in concentrated ownership structures the problem shifts between controlling and minority shareholders [Principal-Principal or simply P-P] (Young et al., 2008; Shleifer & Vishny, 1997). Consequently, minority shareholders bear the risk of expropriation by controlling blockholders [P-P] on top of the basic managerial agency problem [P-A].

Expropriation might be achieved through several forms: by direct or indirect extraction of physical resources, by misallocation of key organizational positions, or by following strategic decisions that advance personal goals at the expense of firm performance (Denis & McConnell, 2003; Young et al., 2008). It is argued that external governance mechanisms, which are assumed to alleviate the basic Principal-Agent problem, such as the takeover market, fail to control Principal-Principal agency problems due to the strong position blockholders enjoy (Setia-Atmaja et al., 2009).

Instead, audit quality which improves transparency and reduces the information asymmetry between controlling insiders and minority shareholders by providing credible checks to the financial reports of the company becomes

vital for alleviating Principal-Principal agency problems (Lin & Liu, 2009; Fan & Wong, 2005). Studies by Choi and Wong (2007) and Woidtke and Yeh (2013) lend further support to this argument with regards to auditor choice and audit committees, respectively.

Choi and Wong (2007) finds that large brand-name auditors serve a more important governance function in countries with weak legal institutions compared with strong ones, from a sample of 39 countries (Choi & Wong, 2007). Additionally, Woidtke and Yeh (2013) find that earnings informativeness is improved when audit committees in East Asia have more independent and accounting expert members. They further argue that the increase in reliability of the reports that is caused by better audit committees more than offsets the detrimental effects associated with blockholder control (Woidtke & Yeh, 2013).

Due to their strong position of high voting power, blockholders are able to directly influence corporate decision making (Djankov et al., 2008), including the appointment of the external auditor and audit committee members (Lin & Liu, 2009; Woidtke & Yeh, 2013; Ho & Kang, 2013). However, in order to maintain the information asymmetry between them and the general public, and to minimize external monitoring pressure, blockholders might dilute the quality of financial reports by avoiding high quality audit structures (Lin & Liu, 2009; Khan et al., 2015).

Ultimately, audit quality serves as an invaluable governance mechanism that helps in the protection of minority shareholders' interests in the absence of

other external governance mechanisms (Cohen et al., 2002; Fan & Wong, 2005; Lin & Liu, 2009). Thus, higher audit quality in weak legal settings is expected to serve a more important governance role, and be in the best interest of minority shareholders, by substituting for the weak external governance in these countries (Choi & Wong, 2007; Fan & Wong, 2005; Woidtke & Yeh, 2013).

Therefore, it is important to investigate the decision on audit quality under the presence of different blockholders in the Saudi market. Appointing a Big Four auditor and an expert independent audit committee decreases the ability of the controlling blockholders from extracting private benefits of control due to the increased monitoring and accompanied improvement in financial reporting that is associated with audit quality. Thus, blockholders might choose such audit quality structures in order to signal to minority shareholders their willingness to employ good governance mechanisms rather than an intent to expropriate them (Fan & Wong, 2005; Woidtke & Yeh, 2013).

5.1.3 Research Gap

Several studies have investigated the relationship between ownership structure and audit quality, however, most of these studies failed to differentiate between different types of blockholders, rather they combined them in a single measure of ownership concentration (Lin & Liu, 2009; Leung & Liu, 2015; Fan & Wong, 2005; Farooq & Tabine, 2015; Rainsbury et al., 2008; García-Sánchez et al., 2012), with few studies investigating the influence of family blockholders (Khan et al., 2015; Ho & Kang, 2013) or government ownership (Wang et al., 2008; Guedhami et al., 2009) in isolation.

Moreover, while audit committee characteristics are generally associated with audit quality, no studies have been found that directly investigated the relationship between ownership structure and audit committees, where only auditor choice and/or audit fees were the ones studied with ownership structure. Furthermore, little is known about the relationship between ownership structure and audit quality in the Middle East, where institutional arrangements and sociocultural aspects differ greatly from the ones investigated in the literature.

Therefore, this study will address this literature gap by comprehensively analyzing audit quality; namely auditor choice and audit committee characteristics, under different types of blockholders; namely family, royal family, government, corporate, managerial and multiple blockholders, present in the Saudi Arabian context. The aim of this study is to examine the level of governance minority shareholder experience under the presence of such controlling blockholders.

Accordingly, the study seeks to answer the research question of, to what degree do blockholders impact the audit quality of Saudi PLCs? Specifically, the objective is to empirically examine the influence of different blockholder types on the auditor choice, whether a Big Four auditor is assigned or not, and on audit committee characteristics; namely the level of independence of the committee from controlling blockholders and the presence of a financial expert on the committee.

The next section provides the theoretical framework of the study. The following section reviews the extant literature on the relationship between ownership structure and audit quality, as well as developing the hypotheses of the study. Afterwards, the research methodology employed will be presented, followed by the results and discussion. Finally, concluding remarks will close the chapter.

5.2 Theoretical Framework

Audit quality is a term that reflects the fairness and credibility of the firm's financial statements, which encompasses both the quality of the internal audit function as well as the external auditor (DeFond & Zhang, 2014). Therefore, audit quality serves a significant governance role that protects the interests of minority shareholders from insider expropriation, through increased oversight over the reporting process which leads to higher levels of transparency and the accompanied reduction in information asymmetry (Cohen et al., 2002).

While it is practical to assess the audit quality ex-post in the case of audit failure, it is challenging, however, to measure the audit quality ex-ante (Francis, 2004). Nevertheless, several measures have been utilized in the literature that aim to reflect the expected level of audit quality, such as audit fees (O'Sullivan, 2000; Ho & Kang, 2013; Khan et al., 2015), auditor size (DeAngelo, 1981; Lennox, 1999; Mansi et al., 2004), auditor tenure (Francis, 2004), auditor industry specialization (Craswell et al., 1995), earnings management (Al-Rassas & Kamardin, 2016; Chaney et al., 2011), audit committee independence (Woidtke &

Yeh, 2013; Krishnan, 2005; Carcello & Neal, 2003), and audit committee financial expertise (Cohen et al., 2002; Malik, 2014; Abernathy et al., 2013).

Out of the different proxies, auditor size, such as Big Four auditors, is the most applied in the literature, due to its clear distinction, ease of measurement and general consensus over their superior audit quality (Lennox, 1999; Francis, 2004; DeFond & Zhang, 2014). Moreover, the audit committee serves a vital role which links the external auditors, the internal audit function and the board, where two characteristics are generally attributed to its effectiveness; namely the independence and financial expertise of its members (DeFond & Zhang, 2014; Carcello & Neal, 2003; Chen & Zhou, 2007).

While audit fees, industry specialization and earnings management might reflect audit quality, they do suffer from high measurement errors, due to lack of consensus over appropriate measuring proxies (DeFond & Zhang, 2014). Moreover, in Saudi Arabia there is no disclosure of audit fees, and there is no industry specialization by auditors, as they audit companies from a wide array of industries (Slamen et al., 2014), it is therefore, not possible to examine them as audit quality measures.

This study will utilize the choice of the external auditor as well as the audit committee characteristics as proxies for audit quality in Saudi Arabia. The following section will illustrate the most relevant theoretical foundations behind the measurements used, and how they are supposed to serve a governance role that protects the interests of minority shareholders.

5.2.1 Agency Theory

With regards to external audit quality, two main factors represent the quality of the external auditor, namely; the ability of the external auditor to detect misstatements, and their willingness to report them (Lin & Liu, 2009; Fan & Wong, 2005). From an agency theoretical perspective, the level of independence of the external auditor from the firm reflects the willingness to report misstatements and provide objective auditing services (DeAngelo, 1981).

Correspondingly, the globally renowned Big Four auditors with their long standing history reflect such quality as they are more independent, rely less on a single client, and have more at stake in the event of reputational damage caused by negligence or colluding behavior, when compared to small auditors (Mansi et al., 2004; DeAngelo, 1981; Francis, 2004).

These Big Four auditors, who are independent from both the firm management and controlling blockholders, are able to increase external monitoring pressure and provide objective reports that alleviates concerns from insider manipulation of accounting and financial reports (Francis, 2004). Consequently, under blockholder control, having a Big Four external auditor is expected to improve the overall audit quality which increases the credibility of the financial statement to end users, including minority shareholders (Khan et al., 2016).

On the other hand, audit committee quality is attributed to the level of independence and expertise of its members (Carcello & Neal, 2003; Krishnan, 2005). Since the audit committee serve at the apex of the audit function, it is

important for it to serve its role and responsibility more effectively in assuring the credibility of the auditing and reporting process employed (Malik, 2014; Krishnan, 2005). Independent audit committees are able to improve audit quality by offsetting management's reports by providing an unbiased reporting process and by encouraging truth telling in external and internal auditors (DeFond & Zhang, 2014).

Independent audit committee members, who are independent from both the management and controlling blockholders, are able to protect the interests of minority shareholders by objectively monitoring the overall audit function of the firm (Woidtke & Yeh, 2013). Furthermore, since the appointment of the external auditor is highly influenced by the audit committee; where the audit committee is responsible for nominating the appointment, dismissal and remuneration of the external auditor, it is argued that independent audit committees demand higher audit quality, including a Big Four external auditor (DeFond & Zhang, 2014; Ho & Kang, 2013).

Ultimately, audit quality, which is reflected in higher independence level of the external auditor and audit committee, serves an invaluable governance mechanism that helps in the protection of minority shareholders' interests, which alleviates both P-A and P-P agency problems (Cohen et al., 2002; Fan & Wong, 2005; Lin & Liu, 2009).

5.2.2 Resource Dependence Theory

Resource dependence theory describes the organizational dependence on contingencies in the external environment (Pfeffer & Salancik, 1978). The theory

emphasizes on the importance of gaining access to vital resources for the organization's survival and growth (Chen & Roberts, 2010; Hillman et al., 2009).

With regards to external audit quality, two main factors represent the quality of the external auditor, namely; the ability of the external auditor to detect misstatements, and their willingness to report them (Lin & Liu, 2009; Fan & Wong, 2005). From a resource dependence theoretical perspective, higher levels of knowledge and expertise the external auditor enjoy enables them to better detect misstatements in the accounting reports of the firm (Al-Rassas & Kamardin, 2016).

Large expert auditors with long standing history, such as the Big Four, possess advance knowledge and skills that enables them to better monitor the firm and achieve a higher level of expertise in performing the auditing task (Lennox, 1999; Francis, 2004; Mansi et al., 2004).

Similarly, audit committee quality is attributed to the level of independence and expertise of its members (Carcello & Neal, 2003; Krishnan, 2005). Knowledge in accounting and financial matters is an essential characteristic for an effective audit committee (Abernathy et al., 2013; Cohen et al., 2002).

Audit committee members who are expert in accounting and financial matters are able to better monitor both the internal and external audits of the firm as well as employing sound audit processes that leads to improved reporting quality (DeFond & Zhang, 2014; Al-Rassas & Kamardin, 2016; Krishnan, 2005).

Overall, higher level of expertise of the external auditor and audit committee, will in turn, lead to improved accounting transparency, reduced information asymmetry, increased external monitoring, and reduced risk of fraud and misstatement, which will ultimately be in the best interest of minority shareholders (DeFond & Zhang, 2014).

5.2.3 Stakeholder Theory

Stakeholder theory presents a shift away from agency theory, which takes a narrow perspective that focusses on the sole interests of shareholders, with an emphasis on the overriding obligations to the wide organizational stakeholders, based on trust and cooperativeness (Chen & Roberts, 2010; Gaur et al., 2015). A stakeholder can be defined as any individual or group who is affected by or is able to affect the achievement of firm objectives (Freeman & Reed, 1983).

It is argued that blockholders tend to influence decision making to serve their interests, even if it was at the expense of other stakeholders (Gaur et al., 2015; Khan et al., 2015). While in two tier board structures the interests of a wider group of stakeholders is fairly reflected, it is difficult to achieve such influence in single tier board structures, such as that present in Saudi Arabia (Bezemer et al., 2014).

Therefore, it is expected that important stakeholders demand better audit quality in order to protect their interests from blockholder control. Researchers have found empirical support for this argument as pressure from stakeholder

groups have been found to play a role in improving financial disclosure, in the form of corporate social responsibility, and the choice of auditor and accompanied audit fees in a concentrated ownership context, namely Bangladesh (Khan et al., 2015; Khan et al., 2013).

Consequently, in addition to the agency expectation where better audit quality serves the best interest of minority shareholders, the stakeholder model is also in support of improved audit quality, that is expected to minimize blockholder ability to expropriate firm resources and represent the interests of a wider group of stakeholders. Improved audit quality, in the form of Big Four auditors and independent and expert audit committees is expected to serve the best interest of the different stakeholders, including minority shareholders,

Islamic religion, or *Sharia*, promotes the representation of various stakeholders, in which the main objective of the firm isn't profit maximization, rather, continuity and societal welfare are the fundamental objectives of the Islamic ethical system (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015).

However, the Saudi legal system is heavily influenced by the Anglo-American system and emphasizes on the protection of shareholders at large without providing detailed measures and tools that help various stakeholders as well as minority shareholders to protect their interests and convey their voices (Almajid, 2008; Fallatah & Dickins, 2012; Piesse et al., 2011).

Therefore, although it is plausible to assume that stakeholder model should form the basis of analyzing the governance in Saudi Arabia from a religious point of view, the actual conduct within Saudi Arabia offers greater support to the self-serving agency model instead.

5.2.4 Signaling Theory

While assigning a Big Four auditor is associated with improved accounting reports and increased external monitoring, it does have its drawbacks, as audit fees would ultimately be much higher when compared to small auditors (Beattie et al., 2001). Therefore, it is expected that firms that assign a Big Four auditor demonstrate higher tendency to induce higher costs for the promotion of better governance (Titman & Trueman, 1986; Datar et al., 1991).

Furthermore, appointing a Big Four auditor limits the ability of firm insiders, including controlling blockholders, to manipulate accounting information, which decreases the risk of extracting private benefits of control (Fan & Wong, 2005). Similarly, assigning audit committees that are independent, from management and controlling shareholders, and expert, in accounting and financial matters, reduces the risk of fraud and improves reporting quality (Krishnan, 2005).

Consequently, assigning a quality auditor and an audit committee that is independent and professional, might be used by controlling insiders in order to signal to minority shareholders their willingness to employ good governance structures and not to intend to expropriate firm resources (Fan & Wong, 2005; Titman & Trueman, 1986; Feldmann & Schwarzkopf, 2003).

Ultimately, improved audit quality, in the form of Big Four auditors and independent and expert audit committees, serves as a signal to the market that the firm undertook better governance decisions that are in the best interest of minority shareholders, and the firm was willing to accommodate the liabilities associated with their choice (Datar et al., 1991).

Moreover, the importance of signaling audit quality becomes especially crucial under the presence of controlling blockholders, who will face increased monitoring and stricter audit checks, which will limit the blockholder's ability to appropriate firm resources and protect the interests of minority shareholders (Fan & Wong, 2005; Woidtke & Yeh, 2013).

The next section will review the extant literature on the theoretical predictions and empirical evidence on the relationship between ownership structure and audit quality and develop the hypotheses of the study for the different blockholder types present in Saudi Arabia.

5.3 Literature Review and Hypotheses Development

A typical characteristic of developing countries is the combination of the presence of dominant blockholders and a weak institutional setting, where laws and regulations regarding the governance of corporations are either absent entirely or cannot be effectively enforced (Yoshikawa et al., 2014). Consequently, external governance mechanisms, such as the take over market, become weak and inactive, and the risk of minority shareholder expropriation by blockholders increases (Mishra, 2011; Young et al., 2008).

Instead, audit quality is expected to reduce the information asymmetry between controlling insiders and minority shareholders by improving the reliability and integrity of the firm's financial reports (Lin & Liu, 2009; Fan & Wong, 2005). Due to their strong position; of high voting power, blockholders have been found to be able to directly influence corporate decision making (Djankov et al., 2008), including the appointment of an external auditor (Lin & Liu, 2009), as well as the audit committee membership (Chau & Leung, 2006).

Nevertheless, in order to maintain the high level of information asymmetry between them and the general public, and to minimize objective monitoring pressure, blockholders might dilute the quality of financial reports by avoiding high quality audit structures (Lin & Liu, 2009; Khan et al., 2015). Consequently, audit quality serves an invaluable governance mechanism that helps in the protection of minority shareholders' interests in the absence of other external governance mechanisms under blockholder control (Cohen et al., 2002; Fan & Wong, 2005; Lin & Liu, 2009).

The extant literature emphasized the benefits of appointing a Big Four external auditor, who are large expert auditors with long standing international history, as these auditors possess advance knowledge and skills, which enables them to better monitor the firm and achieve a higher level of expertise in performing the auditing task (Lennox, 1999; Francis, 2004; Mansi et al., 2004).

Francis (2004) surveyed the literature on the Big Four auditors and audit quality relationship, and found support to the fact that they outperform other auditors and charge higher audit fees, which enables them to invest that premium in providing superior audit services (Francis, 2004; Mansi et al., 2004; Moizer, 1997).

Choi and Wong (2007) present two competing views on the relationship between weak legal environments and the choice of auditor: the strong governance view, and the weak governance view. The strong governance view assumes that auditor quality, reflected by the Big Four, plays a strong bonding role and serves a more important signalling function in weak legal environments, by minimizing information asymmetry, thus substituting for weak legal protection and reduces associated agency costs.

The weak governance view, on the other hand, assumes that in weak legal environments auditor quality is not relevant due to the absence of a disciplining legal system that holds the auditor accountable, which causes the external auditor to collude with the demands of firm insiders instead of building a

reputation based on quality auditing (Choi & Wong, 2007). However, their study, from a sample of 39 countries, finds support for the strong governance view, as their results show that Big Four auditors serve a more important governance function in countries with weak legal institutions (Choi & Wong, 2007).

Thus, Big Four auditors in weak legal settings, and under the presence of controlling blockholders, are expected to serve a more important governance role, and be in the best interest of minority shareholders, by substituting for the weak external governance of these countries (Choi & Wong, 2007; Fan & Wong, 2005).

Equally, in Bahrain, which represents a similar institutional setting to Saudi Arabia in terms of culture and religion, Al-Ajmi (2009) conducted a survey with 300 professionals and reported that Big Four auditors are considered of better quality than local audit firms in terms of achieving the required outcomes from the audit function. This further supports the assertion that Big Four auditors are associated with better audit quality, even in the context of Saudi Arabia (Moizer, 1997; Haniffa & Hudaib, 2007).

Audit committees have gained significant status within the internal audit function after the US Sarbanes-Oxley [SOX] act of 2002 gave specific guidelines on enhancing the power and responsibility of the audit committee over firm reporting process (Naiker & Sharma, 2009; Malik, 2014).

In Saudi public listed firms, the audit committee is at the apex of internal audit, where all listed firms are required to have an established audit committee (Al-Twajry et al., 2004). Audit committees are responsible for supervising the internal audit process, nominating the appointment, dismissal and remuneration of the external auditor, and reviewing the internal audit reports, interim and annual financial statements and the accounting policies employed (CMA, 2010).

Accordingly, the audit committee serves a vital role which links the external auditors, the internal audit and the board (DeFond & Zhang, 2014; Woidtke & Yeh, 2013). Two audit committee characteristics are generally attributed to its effectiveness; namely the independence and financial expertise of its members (DeFond & Zhang, 2014; Carcello & Neal, 2003; Chen & Zhou, 2007).

Audit committees with higher levels of independence and financial expertise are able to serve their required role more effectively, and are found in the literature to be associated with improved audit reporting quality (Woidtke & Yeh, 2013; Abernathy et al., 2013; Cohen et al., 2002; Krishnan, 2005; Al-Rassas & Kamardin, 2016), improved credibility of financial statements (Klein & Zur, 2009; Al-Ajmi, 2009; Carcello & Neal, 2003), and increased demand for quality external auditors, such as the Big Four (Chen & Zhou, 2007; Ho & Kang, 2013; DeFond & Zhang, 2014).

Several studies have investigated the relationship between ownership structure and audit quality, as measured by auditor choice and audit committee characteristics, however, most of these studies failed to differentiate between

different types of blockholders, rather they combined them in a single measure of ownership concentration (Lin & Liu, 2009; Leung & Liu, 2015; Fan & Wong, 2005; Farooq & Tabine, 2015; Rainsbury et al., 2008; García-Sánchez et al., 2012), with few studies investigating the influence of family blockholders (Khan et al., 2015; Ho & Kang, 2013) or government ownership (Wang et al., 2008; Guedhami et al., 2009) in isolation.

Table 5.1 presents a summary of previous studies on the ownership and auditor choice and audit committee characteristics relationship around the world. In the following sections, relevant literature and theoretical arguments will be reviewed for each blockholder type, in order to develop the hypotheses of the study.

Table 5.1 Empirical Studies on Ownership Structure and Audit Quality (Auditor Choice and Audit Committee)

Ownership – Auditors					
Authors & date	Country	Empirical Test	Dependent variable(s)	Independent variables	Results
Fan and Wong (2005)	Multi-Country (East-Asia)	Logit	Big 5	- Voting Rights of Largest Blockholder %	- Positive relationship between Voting Rights and Big 5
				- Cash Flow Rights of Largest Blockholder %	- No relationship between Cash Flow Rights and Big 5
Lin and Liu (2009)	China	Logit	Top 10 Auditor (dummy for largest 10 Auditors)	- Ownership Concentration %	- Negative relationship between Ownership Concentration and Top 10 Auditor
				- Supervisory Board Size	- Positive relationship between Supervisory Board Size and Top 10 Auditor
				- CEO/Chair Duality	- Negative relationship between CEO/Chair Duality and Top 10 Auditor
Leung and Liu (2015)	China	OLS	Auditor Choice (Big 4 and Second Tier Auditors)	- Largest Shareholder %	- U shaped relationship between Largest shareholder and Big 4 and Second Tier
				- Aggregate Ownership of 2 nd to 5 th blockholders %	- Positive relationship between Other Blockholders and Big 4 only
					- Positive relationship between

				- Executive Ownership %	Executive Ownership and Big 4 and Second Tier
Farooq and Tabine (2015)	Multi-Country (Middle East and North Africa)	OLS	Big 4	- Ownership Concentration %	- Positive relationship between Ownership Concentration and Big 4
				- Dividend Payout Ratio	- Negative relationship between Dividend Payout and Big 4
Wang et al. (2008)	China	Logit	Top 10 Auditors (dummy for largest 10 auditors)	- Local State Ownership (dummy)	- Negative relationship between Local State Ownership and Top 10
				- Central State Ownership (dummy)	- Negative Relationship between Central State Ownership and Top 10
Guedhami et al. (2009)	Multi-Country	Logit	Big 4	- Government Ownership %	- Negative Relationship between Government Ownership and Big 4
				- Foreign Ownership %	- Positive relationship between Foreign Ownership and Big 4
Khan et al. (2015)	Bangladesh	Probit & Logit (for Auditor Choice), OLS (for Audit Fees)	- Auditor Choice (KPMG, Big 4 representative, and local auditors)	- Family Control (dummy at 20% and managerial/board position)	- Negative relationship between Family Control and Auditor Choice
			- Audit Fees		- Negative relationship between Family Control and Audit Fees
Ho and	US	Heckman	- Auditor Choice (Big 5,	- Family Control (dummy at 5%	- Negative relationship between

Kang (2013)		Procedure	and Big 4 after the fall of the 5 th)	or managerial/board position)	Family Control and Auditor Choice and Audit Fees
			- Audit Fees	- Excess Voting over Cash Flow Rights	- Positive relationship between Excess Voting Rights and Auditor Choice and Audit Fees
				- Institutional Ownership	
				- Managerial Ownership	- Positive relationship between Institutional Ownership and Auditor Choice, but Negative for Audit Fees
				- Board Independence	
				- Audit Committee Expertise	- Negative relationship between Managerial Ownership and Auditor Choice and Audit Fees
					- No relationship between Board Independence and Auditor Choice and Audit Fees
					- Positive relationship between Audit Committee Expertise and Auditor Choice only
Rainsbury et al. (2008)	New Zealand	Logit	- Audit Committee Independence Dummy	- Managerial Ownership %	- No relationship between Managerial Ownership and Audit Committee characteristics
			- Audit Committee Expertise Dummy	- Blockholder Ownership %	
				- Board Size	- Positive relationship between

				- Board Independence	Blockholders and Audit Committee Independence	
					- Negative relationship between Blockholders and Audit Committee Expertise	
					- Positive relationship between Board Size and Independence and Audit Committee Characteristics	
					- No relationship between Managerial Ownership and Audit Committee Independence and Expertise	
García-Sánchez et al. (2012)	Spain	OLS & Logit	- Audit Committee Independence (% and Dummy)	- Managerial Ownership	- No relationship between Ownership concentration and Audit Committee Independence and Expertise	
			- Audit Committee Expertise (% and Dummy)	- Ownership Concentration %	- Positive relationship between Board Size and Audit Committee Independence only	
				- Board Size	- Positive relationship between Board Independence and Audit Committee Independence and Expertise	
				- Board Independence		

5.3.1 Family Blockholders

Family blockholders are the most common type of concentrated ownership around the world (Singal & Singal, 2011; La Porta et al., 1999). Family control represents a distinctive type of blockholder. Family blockholders, generally, hold non-diversified portfolios, tend to be long-term oriented, and often hold senior managerial positions, thus placing them in a unique position to monitor and influence the firm (Shleifer & Vishny, 1997).

It is argued that controlling family members are well informed, maintain close attachment to the firm, and have high reputational concerns that results in decreased agency problems, and ultimately better performance outcomes (Villalonga & Amit, 2006). Several studies have supported these arguments and found that family controlled firms outperform their non-family counterpart (Anderson & Reeb, 2003; van Essen, Carney, Gedajlovic, & Heugens, 2014; Villalonga & Amit, 2006).

Ho & Kang (2013) found that family firms in the USA, from an S&P 1500 sample, are less likely to assign a Big Four auditor than non-family firms due to the lower agency problems that exist under family control. They also found that audit fees were generally lower for family firms, than non-family firms, which further reflects their lower associated audit risk (Ho & Kang, 2013).

Likewise, in Western Europe, El Ghouli et al. (2015) found that family controlled firms are associated with lower demand for Big Four auditors. They argue that family control substitutes for the need of a Big Four auditor.

Therefore, valuable monitoring by the family reduces the benefit of external monitoring that accompanies having a quality auditor (El Ghouli et al., 2015).

Moreover, Lei & Lam (2013) found that family firms in Hong Kong are more likely to appoint a Big Four auditor in order to signal their adoption of sound governance mechanisms and reducing agency problems to minority shareholders. They also found that family firms incur lower audit fees, which also reflect the lower perceived audit risk of family firms, therefore, family ownership do not present Principal-Principal agency problems in Hong Kong by reducing audit quality (Lei & Lam, 2013).

Similarly, Jaggi & Leung (2007) found that the voluntary establishment of an audit committee in Hong Kong constrains earnings management. They argue that audit committees provide effective monitoring of earnings management even in firms that operate in a family dominated economy, such as Hong Kong (Jaggi & Leung, 2007).

However, family blockholders might also produce Principal-Principal agency problems. Uncontestable entrenched family owners might harm minority shareholders through various forms, such as pursuing non-value maximizing familial political agendas, expropriating firm resources in the form of tunneling or excess perks, or assigning senior positions to under qualified family members (Anderson & Reeb, 2004; Setia-Atmaja et al., 2009). With an aim of expropriating firm resources, at the expense of minority shareholders, family blockholders

might avoid quality auditors to minimize external monitoring pressure and dilute the quality of financial reports.

While the studies of Ho & Kang (2013), El Ghouli et al. (2015), Lei & Lam (2013), and Jaggi & Leung (2007) presented that of developed economies, USA, Western Europe and Hong Kong, respectively, their results might not be well suited to reflect family firms in developing economies where external governance and legal systems are much weaker.

Khan et al. (2015) are amongst the first to study the relationship between family control and audit quality in a developing context. They found that family firms in Bangladesh are less likely to appoint a Big Four auditor than non-family firms. However, while a negative relationship represented a substitution effect between family control and audit quality in developed economies (El Ghouli et al., 2015; Ho & Kang, 2013), Khan et al. (2015) argue that the negative relationship reflects expropriation motivations that incline family firms to dilute audit quality in order to maximize private benefit extraction.

In an early study on audit committees in Saudi Arabia Al-Twaijry et al. (2002) found that audit committees lack true independence and expertise and fail to do their required tasks with regards to the internal and external audit functions. However their study was carried out prior to the introduction of the corporate governance code in 2006, which had a great effect on the level of awareness and compliance with regards to corporate governance related matters in the Saudi market. The culture in Saudi Arabia is characterized by high power distance and

secrecy in corporate dealings (Haniffa & Hudaib, 2007; Bukhari, 2014). In such a context, family blockholders are expected to avoid improved audit quality in order to limit the level of disclosed information and increased monitoring associated with improved audit quality (Al-Twaijry et al., 2004). Additionally, family blockholders in Saudi Arabia might also be motivated to assign external auditors and audit committees that serve their interests, in order to be able to expropriate minority shareholders without the fear of being held liable.

In conclusion, family blockholders in Saudi Arabia are expected to avoid assigning a Big Four auditor and nominate a less independent and qualified audit committee in order to avoid increased monitoring, which in turn might deter any appropriative dealings that causes principal principal agency problems. Therefore the first hypothesis is as follows:

H1. *There is a negative relationship between family ownership and audit quality in Saudi Arabia.*

5.3.2 Royal Family Blockholders

The *Al Saud* family have ruled Saudi Arabia for more than 80 years (Long & Maisel, 2010). Naturally, members of the Saudi royal family enjoy political and relational advantages to other citizens of the country (IISS, 2000). Therefore, they can be considered as politically connected individuals similar to politicians in other countries (Faccio, 2010). Royal family members do not represent the government; rather they represent themselves as individuals with their own set of interests and motivations.

There are several advantages associated with politically connected firms, such as ease of access to finance, lower tax rates and preferential treatment by the government in the form of lower regulatory oversight or financial bailout in times of distress (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2014; Claessens, Feijen, & Laeven, 2008; Faccio, Masulis, & McConnell, 2006; Faccio, 2006; Khwaja & Mian, 2005). These benefits are unique to politically connected firms, and thus puts them in a better position when compared to their non-politically connected counterparts.

Drawing their results from a sample of 28 countries, Guedhami et al. (2014) report that firms with political connections are more likely to hire a Big Four auditor. They argue that politically connected firms appoint a Big Four auditor to improve accounting transparency and signal their intentions of not expropriating firm resources (Guedhami et al., 2014). Furthermore, their results of positive relationship between political connections and Big Four were stronger for firms in countries with less developed governance institutions, and that connected firms with Big Four auditors exhibited lower levels of earnings management and enjoyed higher valuations, and cheaper equity financing (Guedhami et al., 2014).

However, since politically connected firms have easier access to finance and bear less regulatory pressures than non-politically connected firms, they might be more inclined to appropriate firm resources (Guedhami et al., 2014). Even though political connections might add value to all shareholders, they might also generate Principal-Principal agency problems between controlling insiders and

minority shareholders, especially in weak legal settings (Faccio, 2006; Guedhami et al., 2014).

Habib et al. (2017) find that politically connected firms in Indonesia tend to avoid the appointment of a Big Four auditor. Their results show that politically connected firms dilute firm's audit quality and accounting transparency, by appointing non-Big Four auditors, in order to conceal their appropriative behavior and rent seeking activities (Habib et al., 2017).

Likewise, Khan et al. (2016) find that politically connected firms are associated with higher agency costs than their non-politically connected counterparts in Bangladesh. Representing a developing economy with weak legal setting, politically connected managers in Bangladesh abuse their power to expropriate minority shareholders (Khan et al., 2016). They further find that audit quality, represented by a Big Four auditor, moderates the relationship between political connections and agency costs, thus reflecting the importance of audit quality in the protection of minority shareholder interests (Khan et al., 2016).

Similarly, Chaney et al. (2011), report that the quality of accounting reports is lower in politically connected firms than non-politically connected ones, from a sample of 19 countries. They argue that political connected firms might intentionally disclose low quality information in order to mislead investors, or that the superior protection politically connected firms enjoy allows them to devote less efforts to manage discretionary accruals (Chaney et al., 2011). Furthermore, they find that lower reporting quality is associated with higher

cost of debt in non-politically connected firms only, and that politically connected firms face insignificant consequences from their lower reporting quality (Chaney et al., 2011).

Consequently, politically connected firms may be reluctant to improve accounting transparency by improving audit quality, thus rendering the financial statements less informative for outsiders, in order to protect their private benefit extraction motives (Guedhami et al., 2014; Bona-Sánchez et al., 2014; Chaney et al., 2011). Similarly, Saudi royal family blockholders are expected to reduce audit quality, while overlooking the interests of minority shareholders and not bearing the risk of punishment for their actions. By assigning non-Big Four auditors and less independent and expert audit committees, royal family blockholders cause principal principal agency problems. Accordingly, the second hypothesis is as follows:

H2. *There is negative relationship between royal family ownership and audit quality in Saudi Arabia.*

5.3.3 Government Ownership

Government ownership is widely present, especially in less developed countries, where previously fully government owned organizations that went through a privatization process become a public listed company with a majority ownership held by the government (Megginson & Netter, 2001; Dharwadkar et al., 2000). The government, or the state, normally maintains its ownership in previously privatized firms or other listed companies through various governmental agencies or institutions (Abdullah et al., 2014).

Being a state that represents the highest level of authority in a country, governments normally have different objectives from other types of owners, such as political, economical or other incentives (Bradford et al., 2013; Gul, 1999). Firms under governmental ownership are generally regarded as a low default risk by financial institutions, thus are able to have easy access to external financing, regardless of their internal governance structures and financial performance (Gul, 1999; Guedhami et al., 2009; Faccio, 2007).

Albeit limited, few studies on audit quality did consider the influence of government ownership, and have reported either a negative impact on audit quality or found the relationship to be non-significant. Based on a sample of 176 privatized firms from 36 countries, Guedhami et al. (2009) report that government ownership is found to be negatively associated with assigning a Big Four auditor, which reflects the level of accounting transparency. They argue that reduced audit quality impedes outsiders from the detection of corporate resource expropriation due to political intentions of government ownership (Guedhami et al., 2009).

Similarly in China, Wang et al. (2008), find that state owned enterprises are more likely to appoint a small auditor than non-state owned ones. They argue that the easier access to finance state owned enterprises enjoy, due to their low default risk, enables them to avoid sound governance structures, such as lower quality auditor choice, while still obtaining cheap loans (Wang et al., 2008). Furthermore, Liu et al. (2011) also find support for the preferential treatment

state owned enterprises in China enjoy, as they report that government ownership increases the probability of receiving a clean audit opinion report from the external auditor (Liu et al., 2011).

Additionally, Khan et al. (2015) investigated the influence of different stakeholder groups on audit fees and auditor choice in Bangladesh. Their results showed no significant relationship between government ownership and both audit fees and auditor choice (Khan et al., 2015). Similarly, El Ghouli et al. (2015) reported no significant relationship between government ownership and assigning a Big Four auditor in Western Europe (El Ghouli et al., 2015).

The Saudi government played an important role in the development of the capital market and corporate governance in the past decade (Bukhari, 2014). The government of Saudi Arabia aims at improving the corporate governance of the market, which is reflected in the recent issuance and revision of the corporate governance code (CMA, 2010), as well as its intention to open the market to foreign investors (CMA, 2014). It is therefore expected that government ownership in Saudi will signal to the market its intentions to implement governance best practices by improving audit quality and appoint a Big Four external auditor and an independent and expert audit committee. Consequently, the third hypothesis is as follows:

H3. *There is a positive relationship between government ownership and audit quality in Saudi Arabia.*

5.3.4 Corporate Ownership

Corporations invest in other firms in order to cultivate distinctive capabilities and technologies through potential synergies (Pfeffer & Salancik, 1978). Thus their main goal, in general, is not generating short term profits, as opposed to institutional ownership, rather is to develop synergies and/or ensure uninterrupted supply of resources (Sur et al., 2013).

Organizations, therefore, attempt to maintain control over vital resources, by engaging in power in order to reduce, or manage, environmental dependence and uncertainty. By utilizing their control over resources, organizations aim to limit the power of others over them and increase their power over others (Hillman et al., 2009).

Corporate owners have better understanding of the business environment, and are able to directly monitor the management of the acquired firm by appointing their executives or other affiliates as representatives on the board (Sur et al., 2013; Desender et al., 2013).

Additionally, corporate owners generally have nurtured a unique set of knowledge and capabilities that enable them to better govern the acquired firm. Ultimately, corporate ownership is expected to positively influence the overall governance structure of the firm (Desender et al., 2013), which is also reflected in improved audit quality (Lin & Liu, 2009).

Furthermore, corporate owners might signal to the general public their intention not to expropriate minority shareholders, by improving audit quality through the appointment of a Big Four external auditor (Fan & Wong, 2005), or through the allocation of a better audit committee (Feldmann & Schwarzkopf, 2003).

As corporate owners are better capable of governing the firm, in addition to their intention to signal their just treatment to minority shareholders and firm resources, it is expected that corporate blockholders positively influence the decision to appoint a Big Four auditor and an independent and expert audit committee in Saudi Arabia. Therefore, the fourth hypothesis is as follows:

H4. *There is a positive relationship between corporate ownership and audit quality in Saudi Arabia.*

5.3.5 Managerial Ownership

Managerial ownership is expected to have a different influence on audit quality when compared to other types of external blockholders. While the main agency problem [P-A] is expected to be alleviated through increased managerial ownership, which aligns the interests of managers with that of shareholders as they become owners themselves [incentive alignment]. However, at higher levels of managerial ownership, where the management power becomes uncontestable, managers might be inclined to pursue non value maximization policies, such as excessive perks, at the expense of shareholders [entrenchment effect] (Bennedsen & Nielsen, 2010; Claessens et al., 2002).

The so called 'incentive alignment and entrenchment effects' of managerial ownership was first reported by Morck et al. (1988). They found that in the US managerial 'incentive' alignment is achieved at low levels of ownership through improved firm performance, whereas at higher ownership levels, 'entrenchment' effects occur in the form of poorer firm performance. Their finding of non-linear relationship was further supported by several later studies (De Miguel, Pindado, & De La Torre, 2004; McConnell & Servaes, 1990; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

Likewise, Lennox (2005) argue that managerial ownership will follow an incentive and entrenchment effect towards auditor choice. His results show a non-linear relationship between the level of managerial ownership and the appointment of a Big Five auditor in the UK. His study finds that when managerial ownership falls within low and high levels, the relationship becomes significantly negative with appointing a Big Five auditor, which reflects the divergence of interest effect. However, when managerial ownership falls within intermediate levels, the relationship becomes flatter and slightly positive with appointing a Big Five auditor, which reflects the entrenchment effect. He argues that audit quality, in the form of large external auditors, play an essential governance role for shareholders against managerial expropriation concerns (Lennox, 2005).

However, these findings reflect the case of a well developed country, such as the US and UK, thus it might not be a proper representation of other developing

contexts, such as China or even Saudi Arabia, where minority shareholders face difficulty in protecting their interests (Claessens et al., 2002; Djankov et al., 2008; La Porta, Lopez-de-silanes, et al., 2000).

In such contexts, while low levels of managerial ownership might lead to lower need for audit quality due to incentive alignment, high ownership levels of entrenched managers might also lead to lower audit quality due to the incontestability of the entrenched manager by minority shareholders, to avoid quality audit structures (Kalcheva & Lins, 2007; García-Sánchez et al., 2012).

Similarly, in Bangladesh, which represents a developing country, Khan et al. (2015) report that managerial ownership is negatively and significantly associated with the appointment of a Big Four auditor. Their results are in line with the entrenchment argument that managerial ownership experience in less developed countries (Khan et al., 2015). However, both García-Sánchez et al. (2012) and Rainsbury et al. (2008) find no significant relationship between managerial ownership and the level of independence and expertise of the audit committee in Spain and New Zealand, respectively.

Lastly, whether it is the incentive effect or the entrenchment effect that influences managerial ownership towards audit quality in Saudi Arabia, it is expected that the relationship would constantly remain negative. Incentive alignment might substitute for the need of a Big Four auditor and an independent and expert audit committee at low managerial ownership levels. However, entrenched managers at high ownership levels might use their voting

power to minimize monitoring pressure and avoid Big Four auditors and independent and expert audit committees in order to maximize their private benefits of control extraction. Accordingly, the fifth hypothesis is as follows:

H5. *There is a negative relationship between managerial ownership and audit quality in Saudi Arabia.*

5.3.6 Multiple Blockholders

Multiple blockholders refers to firms with more than one blockholder. The presence of such case is assumed to serve a governance role, as the second blockholder is able to limit the expropriation ability of the largest blockholder (Pindado & Requejo, 2015; Attig et al., 2008). Research show that the presence of multiple blockholders increases dividend payment (Faccio et al., 2001; Pindado, Requejo, & Torre, 2012), is related with significant valuation premium (Attig et al., 2008), and is associated with higher corporate risk taking (Mishra, 2011).

Due to their ability and incentive to monitor both the largest blockholder and management, multiple blockholders limit minority shareholder expropriation concerns (Boubaker et al., 2014). Multiple large shareholders are expected to curb the largest blockholder from extracting private benefits of control at the expense of minority shareholders (Attig et al., 2009).

Few studies on audit quality investigated the influence of multiple blockholders, and have all reported that multiple large shareholders substitute for the need of higher quality audits through their improved monitoring of the firm (Ali et al., 2014; El Ghouli et al., 2015; Guedhami et al., 2014). Ali et al. (2014)

report that firms with more than one blockholder pay lower audit fees in France. Which reflects the lower audit effort required by the external auditor due to the lower agency costs associated with multiple blockholder's mutual monitoring (Ali et al., 2014).

Furthermore, Guedhami et al. (2014) and El Ghouli et al. (2015) found a negative relationship between the presence of multiple blockholders and the appointment of a Big Four auditor in a sample from 28 countries and Western Europe, respectively. They argue that multiple blockholders play a valuable governance role, and that committed internal monitoring by multiple blockholders reduces the benefits of external monitoring by a Big Four auditor (El Ghouli et al., 2015; Guedhami et al., 2014).

However, multiple large shareholders are also able to collude with each other and appropriate firm resources at the expense of minority shareholders, especially when a weak legal system exists (Cai et al., 2016). While the negative relationship between audit quality and the presence of multiple blockholders reported in previous studies was caused by the substitutive role that governance mechanisms might play in developed countries, this might not be the case in developing countries. A negative relationship between audit quality and multiple blockholders might reflect their collusive intentions to expropriate firm resources while minimizing external monitoring and disclosure quality.

In Saudi Arabia, the presence of multiple blockholders, of different types in the same company, is common, while minority shareholder rights are not reasonably

protected (Quttainah & Paczkowski, 2012). Furthermore, in Saudi Arabia, family ties and relationships play a significant role in the all aspects of life, including corporate dealings (Bishara, 2011). In such a context, it would be expected that multiple blockholders with relational ties would collude with each other and expropriate firm resources at the expense of minority shareholders. Thus the presence of multiple blockholders would lead to lower levels of audit quality, by avoiding the appointment of a Big Four auditor and a less independent and expert audit committee. Therefore, the sixth hypothesis is as follows:

H6. *There is a negative relationship between the presence of multiple blockholders and audit quality in Saudi Arabia*

After analyzing the theoretical predictions and empirical evidence on the relationship between different types of blockholders and audit quality in order to develop the hypotheses of the study, the next section will present the research methodology employed, which will cover the sample selection, variable measures and model specification of the study. The empirical investigation will help identify the actual role different blockholder types play on audit quality in the Saudi Arabian public listed companies.

5.4 Research Methodology

5.4.1 Sample Selection

The sample of the study comprises all Saudi non-financial public listed companies on Tadawul, the Saudi stock exchange, for the six year period from 2008 to 2013. Tadawul holds 117 traded non-financial listed companies as of September 2014 (ZAWYA, 2014). Excluded from the sample are companies that the full data set variables were not available. A final sample (N) comprises of 619 firm year observations. Table 5.2 shows the total final sample size for each year. Data on audit quality and firm level variables are manually collected from published annual reports, while ownership data is obtained from Reuters Thomson One Banker Database.

Table 5.2 Total firm Samples per Year

Year	2008	2009	2010	2011	2012	2013	Total
N	89	97	102	105	114	112	619

The rationale behind the 2008 start year of the sample is that the disclosure of the 'Board of Directors Report' in the corporate annual report, which discloses the variables required for this study, only became mandatory in 2008 (CMA, 2010), thus data for previous years was impossible to obtain. Furthermore, 2013 was the last year of annual reports available when the data was collected for this research project. Finally, the exclusion of financial firms is justified by their unique business operation and strict legal requirements, as financial companies in Saudi Arabia have a separate governance code (CMA, 2010).

5.4.2 Variable Measures

5.4.2.1 Dependent Variables

The main dependent variable to measure audit quality is the presence of a Big Four auditor, which is measured as a binary/dummy variable that takes the value of 1 if the firm has one of the Big Four serving as its external auditor, and 0 otherwise (**BIG4**). Further tests on audit quality will examine characteristics of the audit committee in order to examine the quality level of internal audit structures. Two variables that reflect audit committee effectiveness will be studied, namely blockholder presence and the presence of a financial expert in the audit committee.

Firstly, the presence of a blockholder in the audit committee represents the level of control the blockholders enjoy over firm audit decisions, which is measured as a binary/dummy variable that takes the value of 1 if the audit committee has at least one blockholder or blockholder representative, and 0 otherwise (**BHAUCM**). This measure reflects the independence of the audit committee from blockholder control. Since the audit committee in Saudi Arabia is required to be composed fully by non-executive members, it is already independent from the management (CMA, 2010). Therefore, it is more reasonable to examine the level of true independence the audit committee enjoys from blockholder influence rather than measuring its percentage of independent members.

Secondly, the presence of a financial expert in the audit committee reflects the expertise level of the audit committee in finance related matters, which is

measured as a binary/dummy variable that takes the value of 1 if the audit committee has at least one member with financial background and/or qualification, and 0 otherwise (**FINEXPERT**). Since the audit function requires dealing with accounts and numbers, financial experts are expected to perform their required task more competently.

5.4.2.2 Independent Variables

The independent variables represent the ownership structure of the firm. Several ownership variables are used in order to investigate how different blockholders influence audit quality. The minimum disclosure level of ownership in Saudi Arabia is 5%. Therefore, blockholders of different types will be considered based on the 5% threshold⁸.

The first ownership variable is family ownership (**FMLOWN**). Family ownership represents the percentage ownership of family or individuals from total issued capital. Secondly, royal family ownership will be considered (**RYLOWN**). The percentage ownership of the Saudi ruling family members, *Al-Saud*, to total issued capital measures RYLOWN.

The third ownership variable measures the percentage of governmental ownership (**GOVOWN**). The government of Saudi Arabia directly holds shares in companies through three wholly-government-owned investment funds, namely, Public Investment Fund (PIF), Public Pension Agency (PPA) and General

⁸ Different cutoff points, 5-20%, 20-50%, and >50%, have been examined in order to identify the level of ownership required to maintain influence. Which showed similar results to our combined findings of >5%.

Organization for Social Insurance (GOSI) (ZAWYA, 2014). There are no private pension funds in Saudi Arabia thus citizens do not have other choices for retirement schemes. Moreover, only the government has the right to decide on the management and operation of these funds, therefore, it is more suitable to classify them as state ownership rather than institutional investors (Almajid, 2008). Due to the lack of competition and government appointment of the management team, these governmental agencies differ greatly in terms of their investment choices and overall governance from traditional institutional investors.

Fourthly, corporate ownership measures the percentage ownership held by a corporate entity (**CRPOWN**). While corporate ownership is common in Saudi Arabia, these corporations tend to be non-financial in nature. Although some corporations are privately held, which might represent a single family or individual investor, no data of ownership of these companies can be obtained. However, this study overlooked corporate ownership where the corporation's registered name is of a family or individual and combined them with family owners instead.

The fifth ownership variable is managerial ownership (**EXECOWN**). EXECOWN represents the percentage ownership of the firm executive management to total issued capital. Executive management could be the CEO, CFO, COO or any member of the senior management team of the firm.

The presence of multiple large shareholders will be the final ownership variable (**MLS**). A binary/dummy variable that measures 1 if more than one blockholder is present in a single firm, and 0 otherwise. In the case of multiple blockholders from the same family, the study will consider them as a single block, rather than multiple blockholders, due to their similar interests and kinship relations that forms a familial coalition (Jara-Bertin et al., 2008). In the aim of measuring the contestability of other blockholders in preventing the controlling blockholders and/or management from expropriating minority shareholders, it is more reasonable to differentiate between multiple blockholders and clear blockholder coalitions.

5.4.2.3 Control Variables

This study will control for factors that are expected to be a determinant of audit quality beside the ownership variables presented earlier. Research shows that certain firm characteristics might influence auditor choice for different reasons.

Firstly, firm characteristics that reflect the level of firm complexity are expected to influence the audit quality decisions, as more complex firms require experienced auditors (Guedhami et al., 2014; Fan & Wong, 2005; Choi & Wong, 2007; Lennox, 2005). Firm size is measured using the natural logarithm of total assets (**FSIZE**). The leverage level is measured as total debt divided by total assets (**LEVERG**). Firm performance is measured through the accounting performance measure of return on assets (**ROA**). Diversification is measured as a binary/dummy variable that takes the value of 1 if the firm has more than one

product or international segments, and 0 otherwise (**DIVERS**). Firm age is measured as the number of years since the establishment of the firm (**AGE**).

Secondly, as this study aims to investigate audit quality under blockholder control, it is important to control for other significant governance variables that might influence the level of audit quality. Out of the various governance variables, the board of directors is considered as the most significant governance mechanism (Daily, Dalton & Cannella, 2003; Fama, 1980; Adams et al., 2010). One of the main board characteristics is the independence of its members (Ben-Amar et al., 2013; Jensen & Meckling, 1976). The nomination committee is responsible for the recommendation of board membership and its committees, including the audit committee. In that regard, the independence level of the nomination committee represents a suitable reflection of the overall internal governance of the firm. Nomination committee independence is measured as the total number of independent members in the nomination committee divided by the size of the committee (**NOMIND**).

5.4.3 Model Specification

Due to the unique nature of the audit quality measures, which reflect the main dependent variables of the study, special care is required in order to avoid potential biases and inconsistent estimates driven by the values of its observations. Namely, the measure of audit quality are the decision to appoint a Big Four auditor (**BIG4**), the presence of a blockholder in the audit committee (**BHADCM**), and the presence of a financial expert in the audit committee (**FINEXPT**), which are constructed as dummy variables that takes the value of 1 if the value is true, and 0 otherwise.

These binary variable are best studied using a binary logistic regression (Logit) that takes into account the unique binary nature of the variables (Al-Najjar & Hussainey, 2009; Abdelsalam et al., 2008; Truong & Heaney, 2007). Therefore, models (1), (2) and (3) below are implemented, which represents logit regressions for the Big Four auditors (**BIG4**), blockholder audit committee control (**BHADCM**), and audit committee financial expertise (**FINEXPRT**), respectively:

$$(1) \quad \Pr (BIG4_{i,t} = 1) = \text{Logit} [\alpha_0 + \beta_1 FMLOWN_{i,t} + \beta_2 RYLOWN_{i,t} + \beta_3 GOVOWN_{i,t} + \beta_4 CRPOWN_{i,t} + \beta_5 EXECOWN_{i,t} + \beta_6 MLS_{i,t} + \beta_7 FSIZE_{i,t} + \beta_8 LEVERG_{i,t} + \beta_9 ROA_{i,t} + \beta_{10} DIVERS_{i,t} + \beta_{11} AGE_{i,t} + \beta_{12} NOMIND_{i,t} + \varepsilon]$$

$$(2) \quad \Pr (BHADCM_{i,t} = 1) = \text{Logit} [\alpha_0 + \beta_1 FMLOWN_{i,t} + \beta_2 RYLOWN_{i,t} + \beta_3 GOVOWN_{i,t} + \beta_4 CRPOWN_{i,t} + \beta_5 EXECOWN_{i,t} + \beta_6 MLS_{i,t} + \beta_7 FSIZE_{i,t} + \beta_8 LEVERG_{i,t} + \beta_9 ROA_{i,t} + \beta_{10} DIVERS_{i,t} + \beta_{11} AGE_{i,t} + \beta_{12} NOMIND_{i,t} + \varepsilon]$$

$$(3) \quad \Pr (FINEXPRT_{i,t} = 1) = \text{Logit} [\alpha_0 + \beta_1 FMLOWN_{i,t} + \beta_2 RYLOWN_{i,t} + \beta_3 GOVOWN_{i,t} + \beta_4 CRPOWN_{i,t} + \beta_5 EXECOWN_{i,t} + \beta_6 MLS_{i,t} + \beta_7 FSIZE_{i,t} + \beta_8 LEVERG_{i,t} + \beta_9 ROA_{i,t} + \beta_{10} DIVERS_{i,t} + \beta_{11} AGE_{i,t} + \beta_{12} NOMIND_{i,t} + \varepsilon]$$

where:

α_0 :	Intercept
i:	Firm factor
t:	Year factor
β :	Regression coefficient
ε :	Error term

Table 5.3 presents the operationalization of the variables used in the model. The following section provides the results of the econometric models, as well as discussing the findings of the results.

Table 5.3 Operationalization of Variables

Variable		Measure
Dependent variables		
Big Four Auditor	BIG4	External Auditor is one of the Big Four (value of 1 if yes and 0 otherwise)
Blockholder in the Audit Committee	BHADCM	The presence of at least one Blockholder or Blockholder representative in the Audit Committee (value of 1 if yes and 0 otherwise)
Financial Expert	FINEXPRT	The presence of at least one Audit Committee member with Financial background/qualification (value of 1 if yes and 0 otherwise)
Independent variables		
Family Ownership	FMLOWN	The percentage of Family Ownership = Family Ownership over Total Issued Capital
Royal Family ownership	RYLOWN	The percentage of Royal Family Ownership = Royal Family Ownership over Total Issued Capital
Government Ownership	GOVOWN	The percentage of Government Ownership = Government Ownership over Total Issued Capital
Corporate Ownership	CRPOWN	The percentage of Ownership by other Corporate Entities = Corporate Ownership over Total Issued Capital
Managerial Ownership	EXECOWN	The percentage of Managerial Ownership = Executive Ownership over Total Issued Capital
Multiple Large Shareholders	MLS	The presence of more than one Blockholder in a single Firm (value of 1 if yes and 0 otherwise)
Control variables		
Firm Size	FSIZE	The natural log of Total Assets
Firm leverage	LEVERG	Total Debt divided by Total Assets
Firm Performance	ROA	ROA = Net Income before tax divided by Total Assets
Diversification	DIVERS	Product and/or International Diversification (value of 1 if yes and 0 otherwise)
Firm Age	AGE	The number of Years since Firm establishment
Nomination Committee Independence	NOMIND	The percentage of Independent Non-executive Directors sitting on the Nomination Committee = Number of Independents over Total Number of Committee Members

5.5 Results and Discussion

5.5.1 Descriptive Statistics

Table 5.4 provides information on the descriptive statistics of variables measured. The results show that roughly 65% of the firms in the sample appointed a Big Four auditor. This result is similar to that reported by Choi & Wong (2007), who found that in weak legal environments the average Big Four market share is 61.83%, while it is 80.18% in strong legal environments. Furthermore, the results show that around 47% of the audit committees in the sample had at least one blockholder or blockholder representative, while roughly 72% of the audit committees had at least one expert in financial and accounting matters.

The major ownership category is family ownership, where on average they hold 17% of the issued equity. Conversely, royal family ownership is the least manifested category, with average ownership of about 3%. Both government and corporate ownership on average hold about 9% of share capital, while managerial ownership is on average only 5%. The presence of multiple blockholders is a common theme in Saudi Arabia, where more than one blockholder in a single company is found in around two thirds of the sample.

Additionally, the figures in Table 5.4 reflect that the variables are not normally distributed across the sample. The skewness of several variables fall beyond ± 1.96 , and the kurtosis mostly fall beyond ± 2 , which reflect the thresholds acceptable for normality (Hair et al., 2010). Therefore, utilizing OLS as an

estimation method for our model is inappropriate, as it will produce biased estimates. Consequently, this study will employ binary logistic (Logit) technique to test the model, given the binary nature of the dependent variables.

Table 5.4 Descriptive Statistics for Dependent, Independent and Control Variables

Variable	Min	Max	Std. Dev.	Mean	Median	Skewness	Kurtosis	N
BIG4	0	1	0.475	0.656	1	-0.656	1.432	619
BHAUCM	0	1	0.499	0.467	0	0.131	1.017	612
FINEXPRT	0	1	0.447	0.725	1	-1.011	2.021	612
FMLOWN	0	0.725	0.217	0.172	0.0815	1.168	3.033	619
RYLOWN	0	0.95	0.117	0.028	0	5.828	41.623	619
GOVOWN	0	0.836	0.177	0.087	0	2.598	9.415	619
CRPOWN	0	0.75	0.161	0.089	0.0001	1.983	6.254	619
EXECOWN	0	0.7	0.133	0.049	0.0001	3.476	14.942	619
MLS	0	1	0.479	0.645	1	-0.604	1.365	619
ROA	-0.672	0.494	0.105	0.069	0.06	-0.938	12.938	619
DIVERS	0	1	0.498	0.546	1	-0.185	1.034	619
FSIZE	17.795	26.550	1.646	21.531	21.3971	0.566	3.389	619
LEVERG	0.004	1.527	0.219	0.365	0.3359	0.700	4.136	619
AGE	2	59	14.339	20.000	20	0.742	2.823	619
NOMIND	0	1	0.291	0.461	0.3333	0.254	2.340	551

Table 5.5 presents the correlation matrix for the dependent, independent and control variables. The results show that the correlation between the variables are comparatively low, mostly below 0.5 thus no indication of a multicollinearity problem in the model (Gujarati, 2003).

Moderately high correlation is found between Big Four auditor and both firm size (FSIZE) and firm leverage (LEVERG) of 0.422 and 0.424, respectively. This reflects the fact that more complex firms, in terms of size of total assets and the degree of leverage, requires higher levels of expert auditing, in the form of Big Four auditors.

Table 5.6 presents the variance inflation factors (VIF) for the variables, where all fall comfortably below the acceptable limit of 10 (Kutner et al., 2004). Thus further confirming that a severe multicollinearity problem is not present in our sample.

The next section will discuss the results of the empirical model as presented in Table 5.7.

Table 5.5 Pearson Correlation Matrix of Dependent and Independent Variables

Variables	BIG4	BHAUCM	FINEXPRT	FMLOWN	RYLOWN	GOVOWN	CRPOWN	EXECOWN	MLS	FSIZE	LEVERG	ROA	DIVERS	AGE	NOMIND
BIG4	1														
BHAUCM	0.233	1													
FINEXPRT	-0.088	-0.064	1												
FMLOWN	0.168	0.175	-0.175	1											
RYLOWN	0.084	-0.098	-0.167	-0.158	1										
GOVOWN	0.142	0.097	0.203	-0.287	-0.056	1									
CRPOWN	0.181	0.114	0.090	-0.306	-0.063	-0.094	1								
EXECOWN	0.140	0.121	-0.035	0.454	0.035	-0.140	-0.132	1							
MLS	0.240	0.223	0.008	-0.025	-0.014	0.292	0.296	-0.092	1						
FSIZE	0.422	0.212	-0.015	-0.156	0.115	0.480	0.294	-0.105	0.363	1					
LEVERG	0.424	0.170	-0.095	0.114	0.049	-0.004	0.195	0.055	0.122	0.420	1				
ROA	0.008	0.116	0.098	0.117	-0.147	0.100	-0.003	0.230	0.119	-0.031	-0.288	1			
DIVERS	0.291	0.042	-0.110	0.254	0.117	0.061	-0.159	0.161	0.004	0.328	0.228	0.045	1		
AGE	-0.361	-0.092	0.098	-0.340	-0.096	0.223	-0.204	-0.204	-0.049	-0.094	-0.354	0.096	-0.149	1	
NOMIND	-0.221	-0.141	0.011	-0.177	0.112	0.040	-0.205	-0.113	-0.119	-0.144	-0.212	-0.093	-0.189	0.169	1

Table 5.6 Variance Inflation Factor (VIF) Values

Variable	VIF
FSIZE	2.36
FMLOWN	2.11
CRPOWN	1.94
GOVOWN	1.93
LEVERG	1.61
AGE	1.47
DIVERS	1.41
EXECOWN	1.39
MLS	1.36
ROA	1.29
RYLOWN	1.22
NOMIND	1.19
Mean VIF	1.61

Table 5.7 Logistic Regression of Big Four Auditor on Ownership Structure and Control Variables

	BIG 4			BHAUCM	FINEXPRT
	Model 1	Model 4	Model 5	Model 2	Model 3
FMLOWN	6.180** (2.20)			6.559** (2.02)	0.771 (0.25)
RYLOWN	6.519 (0.91)			-7.327 (-1.39)	-15.596*** (-2.64)
GOVOWN	9.630** (2.14)			3.974 (0.91)	26.730*** (3.21)
CRPOWN	5.020 (1.23)			1.192 (0.28)	4.578 (0.95)
EXECOWN	2.064 (0.47)			-2.233 (-0.55)	-11.328*** (-3.09)
MLS	-0.081 (-0.10)	-0.825 (-0.10)	0.105 (0.13)	0.356 (0.34)	0.431 (0.44)
OWNCNCTR		7.045*** (2.86)			
OWN5TO20			1.475 (1.10)		
OWN20TO50			0.946 (0.63)		
OWNABV50			3.993** (2.51)		
FSIZE	1.793*** (3.57)	1.842*** (3.63)	1.752*** (3.59)	0.959** (2.02)	-1.102* (-1.90)
LEVERG	-0.908 (-0.46)	-1.036 (-0.53)	0.559 (0.28)	0.655 (0.37)	1.728 (0.69)
ROA	1.002 (0.39)	1.152 (0.45)	1.786 (0.60)	3.216 (0.94)	-3.317 (-0.89)
DIVERS	2.307** (2.46)	2.343** (2.50)	2.069** (2.27)	-0.098 (-0.11)	0.929 (0.69)
AGE	-0.115*** (-2.85)	-0.104*** (-2.76)	-0.083** (-2.28)	-0.013 (-0.23)	-0.493 (-0.98)
NOMIND	-0.166 (-0.15)	-0.129 (-0.12)	-0.130 (-3.84)	-3.541*** (-2.66)	3.983** (2.21)
Constant	-36.859 (-3.64)	-38.158 (-3.75)	-36.900 (-3.84)	-21.128 (-2.16)	27.338 (2.35)

Notes:

1. ***, ** and * denote p-value significance at 1%, 5%, and 10% level, respectively.

2. t-statistics are in parentheses.

5.5.2 Discussion of Results

Model 1, Model 2 and Model 3 in Table 5.7 report the panel data logistic regression (Logit) of auditor choice (**BIG4**), audit committee independence (**BHAUCM**) and audit committee expertise (**FINEXPRT**) on ownership structure and control variables, respectively. Utilizing a panel data set that combines time series and cross sectional observations provides a more informative and robust results due to the higher degrees of freedom when compared to either of them independently (Gujarati, 2003). Furthermore, applying a logit model that takes into consideration the binary nature of the dependent variable is important to avoid biased estimates (Al-Najjar & Hussainey, 2009; Abdelsalam et al., 2008; Truong & Heaney, 2007).

Model 1, Model 2 and Model 3, which are the primary models of the study, report the independent variables of ownership, for the different types of blockholders, along with the firm specific control variables on auditor choice and audit committee characteristics. While models 4 and 5 provide additional tests for a combined measure of ownership, which will be discussed in the section that follows.

The results indicate that family blockholders (**FMLOWN**) are positively and significantly related to assigning a Big Four auditor (BIG4) as well as being present in the audit committee (BHAUCM) at the 5% level, however there is no significant relationship with audit committee expertise (FINEXPRT). These results partly oppose the first hypotheses (H1), which expected family blockholders to negatively influence audit quality in order to minimize

independent monitoring by the external auditors and the audit committee, thus the hypothesis is rejected.

These results provide evidence that family blockholders in Saudi Arabia do not intend to expropriate minority shareholders by avoiding quality external auditors, while at the same time, family blockholders remain attached to the firm and maintain close relationship with the management and overall governance by holding positions in the audit committee (Bukhari, 2014). It is important for family blockholders to improve audit quality by appointing a Big Four auditor in order to sustain their legitimacy, especially when they have strong presence in the firm's top management that enables them to expropriate resources for private benefits. After all family blockholders are the most type of blockholders present in the Saudi market, and if they lose trust from the various stakeholders, it might have a dramatic effect on the entire market.

This result of improved external auditor choice corroborates the findings of Lei & Lam (2013). Lei & Lam (2013) reported that family blockholders in Hong Kong are associated with increased appointment of a Big Four auditor in order to signal their good intentions to minority shareholders. However, this result is opposite to that found in the only study in a developing country on family blockholders and auditor choice, namely by Khan et al. (2015) in Bangladesh. Khan et al. (2015) found that family blockholders were negatively related to the appointment of a Big Four auditor in Bangladesh, which reflects the expropriation motivations of family firms to dilute audit quality.

Two explanations could be linked to the positive relationship found in Saudi Arabia. On the one hand, under the agency theory explanation, family blockholders might view the assignment of a Big Four auditor as a viable governance mechanism that disciplines the management (Lennox, 2005; Francis, 2004). As family investors tend to be under diversified, it is important for them to protect their invested wealth from managerial expropriation, and therefore improve audit quality (Setia-Atmaja et al., 2009; Fan & Wong, 2005). Improved audit quality limits both management and family blockholders from appropriating firm resources. Therefore, family blockholders in Saudi Arabia tend to solve the classical P-A problem with their incentive and power to better govern the firm, instead of introducing P-P agency problems.

On the other hand, under the stakeholder and signaling theories, family blockholders might signal to the various stakeholders, including minority shareholders, their intention of not to expropriate firm resources by improving external auditor quality (Lei & Lam, 2013; Fan & Wong, 2005). By signaling such good commitments, family blockholders aim at gaining investors trust in acquiring firm shares (Titman & Trueman, 1986). While the presence of family blockholders is negatively related to audit committee independence, it is not being used to appropriate firm resources, rather to maintain close control over decision making and firm management, which is reflected in the increased auditor quality choices that audit committees have a strong influence on. The culture in Saudi Arabia is characterized by high power distance and secrecy in corporate dealings (Haniffa & Hudaib, 2007; Bukhari, 2014), and this might

reflect the motivation behind family blockholders' control over the board and its subcommittees.

Accordingly, under the agency, stakeholder and signaling explanations, the results of increased audit quality, by appointing Big Four auditors, show that family blockholders tend not to create expropriation concerns for minority shareholders and the various stakeholders in the Saudi Arabian context. These results might reflect the role that Islamic teachings play in shaping the behavior of family blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values (Muneeza & Hassan, 2014; Lewis, 2005; Rizk, 2008a).

Moreover, royal family blockholders (**RYLOWN**) are found to be negatively and significantly related to the financial expertise of the audit committee (**FINEXPRT**) at the 1% level, while the relationship with auditor choice (**BIG4**) and their presence in the audit committee (**BHAUCM**) is found to be insignificant, therefore partly supporting the second hypothesis (H2) of expected negative relationship with audit quality. The negative relationship expected that royal family blockholders may be reluctant to improve accounting transparency, thus rendering the financial statements less informative for outsiders, in order to protect their private benefit extraction motives (Guedhami et al., 2014; Bona-Sánchez et al., 2014; Habib et al., 2017).

By reducing the presence of financial experts in audit committees, royal family blockholders impair the ability of the audit committee to achieve its required job

effectively, thus hindering the quality of the firm's financial statements. Similarly, Chaney et al. (2011), found that the quality of accounting reports is lower in politically connected firms than non-politically connected ones, from a sample of 19 countries. However, these findings differ from that reported by Guedhami et al. (2014), who find that firms with political connections are more likely to hire a Big Four auditor from a sample of 28 countries. They argue that politically connected firms appoint a Big Four auditor to improve accounting transparency and signal their intentions of not expropriating firm resources (Guedhami et al., 2014).

These results might reflect that the level of audit quality is not important for royal family blockholders in Saudi Arabia, as they are able to extract private benefits of control under any circumstances due to their powerful status in the country. However, while royal family blockholders are associated with lower audit committee expertise, they do not negatively influence external monitoring by a Big Four auditor, nor they reduce the independence of the audit committee to control its function.

Therefore, it is possible that royal family blockholders just dedicate less effort to improve corporate governance due to their favorable position without facing negative consequences from their associated lower audit quality, instead of having the intention to expropriate firm resources (Chaney et al., 2011). Consequently, royal family blockholders in Saudi Arabia do not improve nor hinder audit quality of the firms they invest in, as they devote less effort in trying to improve the governance of the firm.

Furthermore, government ownership (**GOVOWN**) shows a positive and significant relationship with audit quality (BIG4) and audit committee expertise (FINEXPRT), at the 5% and 1% levels, respectively, while the relationship with audit committee independence (BHAUCM) is insignificant. This finding supports the third hypothesis (H3), which expects that government ownership would signal to the market its intentions to implement governance best practices by improving audit quality, thus the hypothesis is accepted. These results contradict previously reported ones in the few studies on audit quality and government ownership around the world, which reported either a negative impact on audit quality or found the relationship to be non-significant.

Based on a sample from 36 countries, Guedhami et al. (2009) report that government ownership is negatively associated with assigning a Big Four auditor. Similarly in China, Wang et al. (2008), find that state owned enterprises are more likely to appoint a small auditor than non-state owned ones. Additionally, Khan et al. (2015) and El Ghouli et al. (2015) report no significant relationship between government ownership and assigning a Big Four auditor in Bangladesh and Western Europe, respectively. It is argued that the easier access to finance state owned enterprises enjoy, due to their low default risk, enables them to avoid sound governance structures, such as lower quality auditor choice, while still obtaining cheap loans (Wang et al., 2008; Attig et al., 2009).

The result of positive relationship between government ownership and audit quality, in the form of increased appointment of Big Four auditors and expert

audit committees, reflects the drive of the government of Saudi Arabia at improving the corporate governance of the stock market (Bukhari, 2014).

Being the custodian of the two Holy Mosques, the Saudi government is also inclined to engage in Islamic driven ethical dealings, which prohibits the misuse of asset and the expropriation of minorities, in order to sustain its legitimacy in the eyes of the Muslim people (Niblock, 2006).

Thus, government ownership in Saudi Arabia tend to signal to the market and the various stakeholders its implementation of sound corporate governance practices by improving audit quality in order to encourage the market in implementing the proposed governance best practice, maintain its religious legitimacy, increase investor confidence in acquiring firm shares, or to increase external monitoring by the audit firm to reduce managerial agency problems.

Additionally, corporate ownership (**CRPOWN**) is found to be insignificantly related to auditor choice (BIG4), audit committee independence (BHAUCM) and audit committee expertise (FINEXPT). These findings do not support the fourth hypothesis (H4), which expected that corporate ownership would lead to higher audit quality as a signal to the general public of their intention not to expropriate minority shareholders, thus the hypothesis is rejected. This result shows that corporate blockholders do not influence the decision to hire a Big Four external auditor, or the composition of the audit committee in Saudi Arabia.

The non-significant relationship between corporate ownership and all audit quality measures studied, could imply that corporate ownership and audit quality act as complimentary governance mechanisms. As corporate owners are better capable of governing the firm, through their developed knowledge and expertise, they are well suited to act as a complimentary governance mechanism to external monitoring by a Big Four auditor and the audit committee, therefore a non significant relationship is found.

Moreover, managerial ownership (**EXECOWN**) is found to be negatively and significantly related to the financial expertise of the audit committee (FINEXPRT) at the 1% level, while the relationship with auditor choice (BIG4) and audit committee independence (BHAUCM) is found to be insignificant, thus partly supporting the proposed negative relationship of hypothesis (H5), which reflects both the incentive and entrenchment effects.

The negative relationship between managerial ownership and audit committee expertise might reflect the intention of entrenched managers at deterring expert monitoring to the audit process of the firm, in order to maximize their capacity to appropriate firm resources. However, managerial ownership is only associated with lower audit committee expertise, as they do not negatively influence external monitoring by a Big Four auditor, nor they reduce the independence of the audit committee to control its function.

Likewise, the finding of negative relationship with audit committee expertise partly corroborates previous results of managerial ownership and audit quality

in contexts such as the UK (Lennox, 2005) and Bangladesh (Khan et al., 2015), where a non-linear relationship and negative relationship with auditor choice were reported, respectively. Furthermore, these results, of mostly insignificant relationship, support the findings of Raisbury et al. (2008) and García-Saánchez et al. (2012), where a non significant relationship was reported between managerial ownership and audit committee characteristics in New Zealand and Spain, respectively.

This mostly non-significant relationship finding could reflect the prevalence of power that external blockholders in Saudi Arabia enjoy when compared to internal/managerial owners. Accordingly, managers in Saudi Arabia might be encouraged by external blockholders through means of increasing their level of ownership, in order to align their interests with that of shareholders, without giving them full control over key governance decisions.

Therefore, due to the dominant power external blockholders possess in the Saudi context, increased managerial ownership would still not allow for their interests to be fully reflected in decision making, such as the appointment of a Big Four auditor and the independence of the audit committee. This also supports the notion that the agency problem in countries with concentrated ownership, such as Saudi Arabia, is the one between controlling and minority shareholders [P-P], rather than the classical problem between management and shareholders [P-A] (Young et al., 2008).

Furthermore, the presence of multiple blockholders (**MLS**) is found to be insignificantly related to auditor choice (BIG4) audit committee independence (BHAUCM) and audit committee expertise (FINEXPRT). This finding does not support the last hypothesis (H6), which assumes that multiple blockholders would collude to expropriate minority shareholders by reducing audit quality, in order to maximize their private benefits of control, thus the hypothesis is rejected. This result of no relationship differs from that reported in the literature, where multiple blockholders were found to substitute for the need of a Big Four external auditor through their improved monitoring of the firm in different countries (Ali et al., 2014; El Ghouli et al., 2015; Guedhami et al., 2014).

Moreover, the finding of non-significant relationship between the presence of multiple blockholders and audit quality could be explained by two competing arguments. On the one hand, the non-significant relationship could imply that both multiple blockholders and audit quality act as complimentary governance mechanisms, in which both protect the interests of minority shareholders through increased monitoring of the firm. Multiple blockholders have the power and incentive to closely monitor the firm and deter appropriative behavior of insiders, and might therefore complement audit quality without having a direct effect on it (Attig et al., 2009).

On the other hand, the non-significant relationship could also reflect that multiple blockholders in Saudi Arabia are not able to contest the demands of the controlling shareholders, even on audit quality decisions, and thus multiple blockholders become an ineffective governance mechanism. The strong

emphasis on relational ties and the strong power distance the people of Saudi Arabia, and Arabs in general, occupy could reflect such behavior, thus multiple blockholders might not challenge the authority of the largest shareholder (Chahine & Tohmé, 2009).

While it is difficult to identify which of the two arguments holds in Saudi Arabia, it is fair to assume that the presence of multiple blockholders does not reduce the governance of the firm by lowering audit quality, therefore multiple blockholders do not collude to expropriate firm resources and enjoy private benefits of control, at the expense of minority shareholders in Saudi Arabia.

Several control variables show significant relationship with the studied audit quality measures. In support to the firm complexity argument, which assumes the need for larger and more experienced audit firms, both firm size (**FSIZE**) and firm diversification (**DIVERS**) show a positive and significant relationship with assigning a Big Four auditor (BIG4) at the 1% and 5% levels, respectively. Firms that are more diversified and firms that are larger are considered as more complex firms, thus require more diverse skills and monitoring efforts, which is expected to be provided by Big Four external auditors (Beattie et al., 2001; Fan & Wong, 2005; Lennox, 2005).

Additionally, with regards to audit committee characteristics, firm size (**FSIZE**) is found, strangely, to be negatively related to audit quality, were the relationship is found to be positive and significant with the presence of a blockholder in the audit committee (BHAUCM) at the 5% level, and negatively

and significantly related to the expertise of the audit committee (FINEXPRT) at the 10% level. This might reflect the motivation of blockholders to maintain close control over the audit committee in large firms by occupying its membership, due to the sensitivity of the role the audit committee plays in such significant firms.

Moreover, in support of the governance argument of the firm, the level of independence of the nomination committee (**NOMIND**) is found to be positively related to the audit quality in terms of audit committee structure. The relationship between nomination committee independence and the presence of a blockholder in the audit committee (BHAUCM) is negative and significant at the 1 % level, while it is found to be positive and significant with the expertise of the audit committee (FINEXPRT) at the 5% level. The higher the level of independence the nomination committee enjoys, the higher the quality of the audit committee characteristic is in terms of reflecting minority shareholder interests.

Finally, firm age (**AGE**) is found to be negatively and significantly related to the appointment of a Big Four auditor (BIG4) at the 1% level. This finding might reflect the need for newly established firms to assure investors about their sound audit structure. New firms have high levels of information asymmetry and therefore are encouraged to improve audit quality to reduce the risk for potential investors (Titman & Trueman, 1986; Copley & Douthett Jr., 2002; Datar et al., 1991). On the other hand, mature firms that have long standing history of solid performance and governance structures need less of a signaling device to

outside investors in the form of Big Four auditor. These firms have gained experience in improving their audit structures and have established confidence with shareholders over a long period of time.

5.5.3 Robustness Checks

In order to further examine the robustness of the results, several models have been employed. Models 4 and 5 in Table 5.7 examine the role of ownership concentration on the audit quality measure of auditor choice regardless of the type of blockholder. Model 4 measures the entire combined ownership concentration of over 5% (**OWNCNCTR**), whereas Model 5 divides the level of concentration into three groups; comprising a dummy variable that equals 1 if the total ownership concentration in a firm falls under each threshold of 5% to 20% (**OWN5TO20**), 20% to 50% (**OWN20TO50**) and over 50% (**OWNABV50**), and 0 otherwise. The motivation behind this measurement is to examine whether blockholders of different levels of ownership influence audit quality differently or not. Different results for different levels of ownership could signal the incentive and entrenchment effects previously documented in the literature (De Miguel et al., 2004; McConnell & Servaes, 1990; Morck et al., 1988; Short & Keasey, 1999; Thomsen & Pedersen, 2000).

The results of Model 4 demonstrate that ownership concentration (**OWNCNCTR**) is positively and significantly associated with the appointment of a Big Four auditor (BIG4) at the 1% level. This result further supports the previous findings, where all blockholder types in Saudi Arabia with a significant relationship to auditor choice are found to be positive; namely family and government blockholders. Therefore, blockholders in the Saudi context, of any type, do not tend to expropriate minority shareholders; rather they positively influence audit quality in terms of assigning a Big Four auditor.

Additionally, Model 5 reveals that the blockholder positive influence on audit quality differs at different concentration thresholds. Where ownership thresholds of 5% to 20% (**OWN5TO20**) and 20% to 50% (**OWN20TO50**) are found to be non-significant with auditor choice (BIG4), and only ownership over 50% (**OWNABV50**) is found to be positively and significantly related to the appointment of Big Four auditor (BIG4) at the 1% level.

These results might reflect the severity of the agency problem when a blockholder owns more than 50% of the firm (**OWNABV50**), consequently the majority controlling blockholder becomes inclined to assign a quality Big Four auditor to assure minority shareholders his good intentions not to expropriate firm resources due to his uncontestable position. This could also reflect that in Saudi Arabia moderate levels of ownership acts as a complementary governance mechanism to the appointment of a Big Four auditor.

Finally, in both Model 4 and Model 5, the results show similar findings with the separated ownership and auditor choice for all the control variables. Thus lending further support to our findings, as the results did not differ by differentiating between owner types, or combining them into a single measure.

The following section provides the concluding remarks of this chapter, which includes the main findings and contribution to knowledge.

5.6 Conclusion

This chapter investigated the role of blockholders on the level of audit quality in Saudi public listed companies. High quality audits, proxied by a Big Four auditor and an independent and expert audit committee, reduces the information asymmetry between controlling insiders and minority shareholders by providing credible checks to the financial reports and improving the overall auditing function of the firm. The level of audit quality under different types of controlling blockholders indicates the degree of minority shareholder expropriation concerns, as lower quality audits facilitate the manipulation of the accounts by controlling insiders to conceal any appropriative dealings.

Panel data logistic (logit) regression models were used to test the relationship between different blockholder types, namely family, royal family, government, corporate and managerial ownership, and different audit quality measures, namely auditor choice (BIG4), audit committee independence (BHAUCM) and audit committee financial expertise (FINEXPRT). After controlling for conventional determinants of audit quality, the results for 117 non-financial listed companies in Saudi Arabia from 2008-2013 show that minority shareholder interests are mostly protected under control by all types of blockholders.

The findings of the study reveal that blockholders do not reduce audit quality in order to maximize private benefit extraction in Saudi Arabia as shown in Table 5.8. Rather family and government ownership positively and significantly

influence audit quality, while other types of blockholders do not have significant influence on audit quality negatively.

Table 5.8 Summary of Hypotheses and Empirical Findings of Blockholder and Audit Quality Relationship

Blockholder Type	Expected			Findings		
	Big Four	AuditCommt. Indep.	AuditCommt. Expert.	Big Four	AuditCommt. Indep.	AuditCommt. Expert.
Family	-	-	-	+	+	no
Royal Family	-	-	-	no	no	-
Government	+	+	+	+	no	+
Corporate	+	+	+	no	no	no
Managerial	-	-	-	no	no	-
MLS	-	-	-	no	no	no

These results might reflect the role that Islamic teachings play in shaping the behavior of blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values (Muneeza & Hassan, 2014; Lewis, 2005). The strong influence of the Islamic religion on Saudi Arabia is far reaching, and might well demonstrate the favorable conduct of blockholders, who protect the interests of minority shareholders, as well as other stakeholders, by improving audit quality of the firm, which decreases the level of information asymmetry between controlling insiders and the rest of the market.

The results might further reflect the institutional legitimacy of minority shareholder protection that controlling blockholders are pressured to cope with in order to gain the trust of the general public to invest in the firm's stocks. The highly concentrated ownership of the Saudi capital market, as well as the powerful position controlling families and the government enjoy, creates a situation where the expropriation of minority shareholders remain a huge concern, and therefore it becomes crucial for blockholders to signal their intentions of protecting minority shareholders and serve the best interest of the firm instead by improving audit quality, for example (Ho & Kang, 2013; Edmans, 2014).

From a theoretical standpoint, the findings of the study indicate that blockholders of different types in Saudi Arabia tend to reduce the agency problem inherent in public listed companies under their presence and act in the best interest of other stakeholders, including minority shareholders by improving audit quality. These findings might offer assurance to different stakeholders that blockholder presence in Saudi Arabia is not detrimental to the firm, and that the interests of current and potential shareholders are protected.

This study contributes to the literature in several ways. Firstly, this study provides one of the earliest empirical investigations on the blockholder and audit quality relationship in Saudi Arabia. Saudi Arabia reflects a unique institutional setting that differs greatly from that of the US (Ho & Kang, 2013), European (Lennox, 2005; El Ghouli et al., 2015; García-Sánchez et al., 2012), New Zealand (Rainsbury et al., 2008) Chinese (Lin & Liu, 2009; Leung & Liu, 2015;

Wang et al., 2008), Bangladesh (Khan et al., 2015) or even East Asian contexts (Fan & Wong, 2005), which have been investigated in the literature.

Secondly, this study combines all the types of blockholders present in the Saudi market, which includes a unique type of royal family members, which are similar to politically connected owners. Studies on the ownership and auditor choice generally fail to differentiate between different types of blockholders, rather they combine them in a single measure of ownership concentration (Lin & Liu, 2009; Leung & Liu, 2015; Fan & Wong, 2005; Farooq & Tabine, 2015), or only focus on a single blockholder type, such as family (Khan et al., 2015; Ho & Kang, 2013), or government (Wang et al., 2008; Guedhami et al., 2009). Therefore, this study is one of the few papers that combine the simultaneous influence of all the different blockholder types on audit quality.

Finally, this study increases our understanding of the dynamics of the Saudi capital market, which is largely understudied, by examining the principal principal agency problem [P-P] between controlling and minority shareholders. This is achieved by studying the audit quality and ownership structure relationship, which reflects the level of expropriation concerns minority shareholders encounter under the presence of controlling blockholders. By increasing the information asymmetry between them and minority shareholders, blockholders are able to maximize the private benefit extraction through minimizing monitoring by a Big Four auditor and an independent and expert audit committee.

Chapter Six

Conclusion

6.1 Introduction

This thesis investigates the role of blockholders in the governance of Saudi public listed companies. Public listed companies play a vital role in the global economy, as the invention of public listed companies “has provided vast employment, fuelled huge economic growth and created untold wealth” (Tricker, 1993, p.2). The Saudi stock market, Tadawul, is the largest and most liquid in the Middle East and North Africa region (Tadawul, 2014; Koldertsova, 2010). Tadawul had a total market capitalization of over 500 Billion USD as of October 2014 (ZAWYA, 2014).

Saudi Arabia presents a unique setting, where religious, cultural and social factors, that are similar to those of other Arab and Islamic nations, play an important role in the day to day lives of the society. Furthermore, Islam is the only legal religion in Saudi Arabia, and Islamic law, referred to as *Sharia*, serves as its constitution (CIA, 2014). Blockholders are widely present in the Saudi stock market; where government and family blockholders control more than two thirds of the companies listed in Tadawul (Di Benedetto & Berg, 2009; Quttainah & Paczkowski, 2012). Given the prevalence of blockholder presence in Saudi Arabia, it is vital to understand the role they might play in the governance of public listed companies, and to what degree are minority shareholders prone to expropriation.

In order to examine the level of influence blockholders have on corporate governance, the preceding three chapters focused on three key governance measures, namely the board of directors, dividends and audit quality, respectively. In doing so, the aim of the thesis is to answer the question of: 'How do blockholders influence the governance of Saudi public listed corporations?'

Each study examined the influence of the different blockholder types present in the Saudi market, namely family, royal family, government, corporate and managerial ownership, while controlling for various factors that are known to have an impact on the governance measures in question. The studies examined data from 117 non-financial listed companies in Saudi Arabia from 2008-2013, with a final sample (N) of 619 firm year observations.

The choice of these mechanisms is motivated by several factors. Firstly, the board of directors is regarded as the most significant governance mechanism (Daily, Dalton & Cannella, 2003). Similarly, Fama (1980, p.294) views the board of directors as the "ultimate internal monitor". The board of directors has the power to hire, fire, and compensate top executives (Fama & Jensen, 1983). Furthermore, Anderson and Reeb (2004) argue that in closely controlled firms minority shareholders heavily rely on the board of directors to mitigate blockholder expropriation, where board effectiveness is reflected in its level of independence.

Secondly, dividend is considered as a mechanism that reduces the free cash flow available for expropriation (Jensen & Meckling, 1976; Jensen, 1986). Paying

out by the firm in the form of dividends reduces the cash available under managerial or blockholder discretion (Faccio, Lang, & Young, 2001; Jensen, 1986; La Porta, Lopez-de-silanes, Shleifer, & Vishny, 2000; Setia-Atmaja et al., 2009). Moreover, dividend payment is a financial commitment that places the management under external scrutiny when needing to raise external funding (Shleifer & Vishny, 1997; Easterbrook, 1984).

Thirdly, improving audit quality, such as appointing a Big Four auditor, decreases the ability of the blockholder to extract private benefits of control through increased oversight over the reporting process which leads to higher levels of transparency. Thus, it might be used by blockholders themselves in order to signal to minority shareholders their willingness to employ good governance mechanisms and not to intend to expropriate them (Fan & Wong, 2005).

As such, the board of directors, dividends and audit quality can all be considered as mechanisms to control for both P-A and P-P agency problems (Setia-Atmaja et al., 2009). Given the central role of the board, dividend and audit quality in the protection of minority shareholders, this study investigated the respective role of these governance mechanisms under the presence of different types of blockholders in the context of Saudi public listed companies.

While each chapter represents a stand alone research paper with its own findings and discussion, the combined results of the three studies provide superior understanding of the role blockholders play in the governance of Saudi

public listed companies. Accordingly, this concluding chapter will summarize the findings of the entire thesis, discuss possible causes, significance and implications of these findings, and suggest fruitful areas for future research.

6.2 Findings and Discussion

The first empirical study, chapter 3, examined the role of blockholders on the structure of the board of Saudi public listed companies. The level of board independence is assumed to reflect the degree of minority shareholder representation in the decision making and overall governance of the firm. Random effects (RE) and fixed effects (FE) models were used to test the relationship between different blockholder types and board independence. After controlling for conventional determinants of board structure, the results show that that minority shareholder interests are not well represented through higher level of board independence under control by all types of blockholders.

The findings of chapter 3 reveal the possible existing P-P agency problem between all types of blockholders and minority shareholders in Saudi Arabia, as the former is associated with less independent board representation. Family ownership, government ownership, corporate ownership and multiple blockholders have all been found to be significantly associated with less independent boards. It is possible that controlling blockholders maintain control over the board in order to better monitor the firm and act as stewards in the best interest of all, or to deter external monitoring by independent directors in order to maximize their private benefit extraction.

The second study, chapter 4, investigated the role of blockholders on the dividend policy of Saudi public listed companies. The level of dividend payout under different types of blockholders reflects the degree of minority shareholders' concern regarding the expropriation of firm resources by controlling blockholders. Lower dividend payments indicate higher propensity for private benefit extraction by blockholders due to the increased free cash flow available for appropriation. A Logit and Tobit models were used to test the relationship between different blockholder types and both dividend decisions and dividend ratio, respectively.

The findings of chapter 4 reveal that blockholders do not reduce dividends in order to maximize the resources available for private benefit extraction in Saudi Arabia. Rather family, royal family, government, corporate and multiple blockholders, all positively influence dividend policy, either to signal their fair treatment to minority shareholders and stakeholders at large, or to utilize dividends as a governance mechanism that reduces the free cash flow available under managerial discretion.

The third empirical study, chapter 5, investigated the role of blockholders on the level of audit quality in Saudi public listed companies. High quality audits, proxied by a Big Four auditor and an independent and expert audit committee, reduce the information asymmetry between controlling insiders and other stakeholders by providing credible checks to the financial reports and improving the overall audit function of the firm. The level of audit quality under different

types of controlling blockholders indicates the degree of minority shareholder expropriation concerns, as lower quality audits facilitate the manipulation of the accounts by controlling insiders to conceal any appropriative dealings. Panel data logistic regression (Logit) models were employed to test the relationship between different blockholder types and auditor choice, audit committee independence and audit committee expertise.

The findings of chapter 5 further reveal that the presence of blockholders in Saudi Arabia is not associated with reduced audit quality. Rather family and government ownership positively and significantly influence audit quality, by assigning a Big Four external auditor and improving audit committee independence and expertise, while other types of blockholders do not have any significant influence on the overall audit quality of the firm. Ultimately, blockholders in Saudi Arabia do not hinder audit quality and act in the best interest of the different stakeholders.

Overall, the results show that the rights and interests of minority shareholder and other stakeholders are fairly protected under blockholder control in Saudi public listed companies. The initial results, in chapter 3, indicate that blockholders maintain control over board representation, which enables them to expropriate firm resources and exacerbate the agency problem. The exclusion of outside independent directors might reflect the dominance of the Arabian culture in Saudi Arabia, which is characterized by high power distance and strong levels of secrecy in business dealings (Haniffa & Hudaib, 2007; Bukhari, 2014). By allowing increased independent representation on the board,

blockholders become obligated to expose information they otherwise regard as private to outsiders.

However, further analyses, in chapters 4 and 5, reveal that blockholders actually act in the best interest of the firm and curb managerial self serving behavior by positively influencing the corporate governance, through improved dividend policy and audit quality under their control. These results might reflect the role that Islamic teachings play in shaping the behavior of blockholders within the Saudi capital market, where fair treatment and just dealing represent core Islamic values (Muneeza & Hassan, 2014; Lewis, 2005). The Islamic ethical system promotes the protection of the rights of the various stakeholders and urges humans to act as stewards entrusted in achieving continuity and societal welfare (Ali et al., 2017; Rizk, 2014; Bedoui & Mansour, 2015).

The strong influence of the Islamic religion on Saudi Arabia is far reaching, and might well demonstrate the favorable conduct of blockholders (Bukhari, 2014), who act as stewards and are found to protect the interests of other stakeholders by positively influencing the dividend policy and audit quality of the firm while maintaining control over the board. The stewardship rationalization can best symbolize the Islamic principle of vicegerency, which is expected to have an influence on blockholders in Saudi Arabia, who should act in the best interest of all stakeholders.

The results might further reflect the institutional legitimacy controlling blockholders are pressured to cope with towards minority shareholder

protection in order to gain the trust of the general public to invest in the firm's stocks. The highly concentrated ownership of the Saudi capital market, as well as the powerful position controlling families and the government enjoy, creates a situation where the expropriation of firm resources remain a huge concern, and therefore it becomes crucial for blockholders to signal their intentions of protecting minority shareholders and serve the best interest of the firm instead (Pindado et al., 2012; Edmans, 2014).

Ultimately, the institutional setting in Saudi Arabia, which is characterized by weak protection of minority shareholders in addition to the wide presence of blockholders, enables controlling blockholders to expropriate minority shareholders and enjoy private benefits of control. However, the results of this thesis show that blockholders in Saudi Arabia engage in direct monitoring and are associated with improved governance of public listed firms.

Over the past two decades, the focus of Islamic corporate governance development has mainly been directed towards Islamic financial institutions (IFI). In the context of IFIs a unique Islamic governance system that differs from the Anglo-American or European models of corporate governance has evolved over time with its distinctive set of features, such as the establishment of a Sharia supervisory board (Mollah & Zaman, 2015; Mansour & Bhatti, 2018). However, there has not been strong development in the field of corporate governance for non-financial Islamic corporations. Therefore, Islamic countries, such as Saudi Arabia tend to adopt systems that have been developed in non-Islamic contexts, such as the OECD principles of corporate governance (Al-Bassam et al., 2018).

While the governance system in Saudi Arabia is mostly based on an Anglo-American shareholder model, due to the underdevelopment of a solid Islamic corporate governance framework (Mansour & Bhatti, 2018), the results of this thesis indicate that the market operates more towards a stakeholder model. The results of this unique environment reflect the potential moderating role of the Arabian culture, of secrecy and high power distance, and the Islamic ethical system, that promotes societal welfare, in shaping the relationship between blockholders and minority shareholders that shifts away from the classical expectations of the Anglo-American agency expectations (Murphy & Smolarski, 2018).

6.3 Contributions and Implications

This study contributes to the literature in several ways. Firstly, this study contributes to the P-P relationship and the private benefits of control associated with large shareholders by investigating the influence of blockholders on the governance of PLCs in a newly investigated setting, namely Saudi Arabia. This study provides a primary empirical investigation on the blockholder and governance relationship in Saudi Arabia while taking into consideration different types of blockholders and their respective level of ownership. Saudi Arabia reflects a unique institutional setting, where religious, cultural and social factors play an important role in the day to day lives of the society, that differs greatly from what have been generally investigated in the corporate governance literature, and the results of this thesis demonstrate how these factors affect the

influence of blockholders on corporate governance and the protection of minority shareholders.

Secondly, this study combines all types of blockholders present in the Saudi market. Studies on ownership and corporate governance generally fail to differentiate between different types of blockholders, rather they combine them in a single measure of ownership concentration or study a particular type in isolation. This study contributes to the literature on the role of multiple blockholders in corporate governance, by examining their relationship with key governance mechanisms, as the presence of competing blockholders might have different effects on the governance of the firm (Maury & Pajuste, 2005; Attig et al., 2008; Attig et al., 2009; Edmans & Manso, 2009). Moreover, this study contributes to the political connections literature by analyzing the governance influence of blockholders from the Saudi royal family, who possess financial, legal and social advantages over other types of owners in the country (Bona-Sánchez, Pérez-Alemán, & Santana-Martín, 2014; Faccio, 2010; Fan, Wong, & Zhang, 2007; Khwaja & Mian, 2005).

Finally, this study contributes to the Islamic business ethics literature by studying the corporate governance structures under blockholder control from a majority Islamic country, namely Saudi Arabia, where the results reveal that blockholders tend not to impair the governance of public listed companies under their control. Furthermore, the results of this thesis increase our understanding of the dynamics of the Saudi capital market by examining the behavior of blockholders towards minority shareholders and firm governance.

The results of this study reflect the state of governance that public listed firms in a developing Arab and Islamic country from the Middle East encounter under the control of blockholders. These results are of interest to academics, practitioners and policy makers in developing countries in general, and the Middle East and Saudi Arabia in particular. Scholars can build on the findings of this thesis to better understand the governance structures in an Arab and Islamic context. Local and international investors become more aware of the environment of the Saudi market when prompted to make investment decisions.

Policy makers also recognize the severity of the agency problem that minority shareholders face under blockholder control, and thus be informed about the functioning of the market in order to make appropriate legislation. As discussed in 2.6.2, the Saudi Corporate Governance Regulations are highly influenced by Western codes and does not reflect the factors that are unique to Saudi Arabia, such as the Islamic religion and local culture. The results of this study indicate that institutional factors play an important role in shaping the behavior of individuals, therefore, the Saudi CMA should consider developing a corporate governance code that is tailored for the Saudi market specifically, which encompasses Islamic aspects that is best suited for this context.

6.4 Limitations and Future Research

This study is subject to limitations that need to be taken into account. Firstly, this study only covers a single country, namely Saudi Arabia, therefore limiting

the generalizability of the results. While the country is assumed to be a representative of Arab countries in general and the Middle East in particular, in terms of market development, religion and culture, a multi-country analysis might provide richer insights that provide more generalizable results. A comparative study that includes several developing and developed economies will also provide a greater understanding of the role blockholders play under different institutional settings.

Secondly, this study only covered a period of six years, due to limitation in data availability and time constraints, as there are no databases that contain corporate governance data of Saudi public listed companies, which is required to be hand collected from corporate annual reports. Therefore, future longitudinal studies might benefit from a large sample that spans over a larger period of time, which could provide results that are more robust and reliable. Furthermore, as the Saudi market starts to develop further, and the level of disclosure increases, future studies can examine and control for additional factors that might have an effect on the role of blockholders in the governance of public listed companies.

Thirdly, while this study focused on the influence of blockholders on different governance mechanisms in order to reflect the level of minority shareholder expropriation concerns, however the financial outcomes of these decisions has not been considered. Future research might measure the effect of such decisions on the future performance of the firm or the share price reaction to changes in these mechanisms in order to better understand their impact on firm performance.

Fourthly, while this study emphasized on the possible influence of Islamic religion on the behavior of blockholders and the corporate governance structure in Saudi Arabia, it failed to incorporate and quantify such variables in the empirical process employed in the three empirical chapters. Endogenising Islamic aspects into the empirical model might be a fruitful area for future research in Saudi Arabia specifically, and other Islamic contexts, in order to measure the level of influence Islam as a religion has on organizational structures and outcomes.

Finally, this study only employed quantitative analyses on different variables that measure ownership structure and corporate governance, while the results should inform us about potential relationships; it fails to uncover the underlying processes and motivations behind these relationships (McNulty et al., 2013). Future studies could employ a qualitative enquiry, in the form of interviews with blockholders, senior executives and other stakeholder groups in Saudi Arabia in order to open the black box of blockholder influence over the governance of public listed companies and further advance the findings of this study. Such future studies could provide fruitful insights not reflected by pure quantitative analyses.

References

- Abdelsalam, O., El-Masry, A. & Elsegini, S., (2008). Board composition, ownership structure and dividend policies in an emerging market: Further evidence from CASE 50. *Managerial Finance*, 34(12), pp.953–964.
- Abdul Rahman, A.R., (1998). Issues in Corporate Accountability and Governance: An Islamic Perspective. *American Journal of Islamic Social Sciences*, 15(1), pp.55–69.
- Abdullah, S., Abdullah, A. & Redzuan, R., (2014). The Effects of Government and State Ownership on Dividends. *Journal of Entrepreneurship and Business*, 2(1), pp.49–57.
- Abernathy, J.L., Herrmann, D., Kang, T. & Krishnan, G. V., (2013). Audit committee financial expertise and properties of analyst earnings forecasts. *Advances in Accounting*, 29(1), pp.1–11.
- Abu-Tapanjeh, A.M., (2009). Corporate governance from the Islamic perspective: A comparative analysis with OECD principles. *Critical Perspectives on Accounting*, 20(5), pp.556–567.
- Adams, R. & Ferreira, D., (2008). One Share-One Vote: The Empirical Evidence. *Review of Finance*, 12(1), pp.51–91.
- Adams, R., Hermalin, B. & Weisbach, M., (2010). The role of boards of directors in corporate governance: A conceptual framework and survey. *Journal of Economic Literature*, 48(1), pp.58–107.
- Adjaoud, F. & Ben-Amar, W., (2010). Corporate Governance and Dividend Policy: Shareholders' Protection or Expropriation? *Journal of Business Finance & Accounting*, 37(5–6), pp.648–667.
- Aguilera, R. V. & Crespi-Cladera, R., (2016). Global corporate governance: On the relevance of firms' ownership structure. *Journal of World Business*, 51(1), pp.50–57.
- Aguilera, R. V. & Jackson, G., (2010). Comparative and International Corporate Governance. *The Academy of Management Annals*, 4(1), pp.485–556.
- Ahmed, H., (2012). Islamic Law, Investors' Rights and Corporate Finance. *Journal of Corporate Law Studies*, 12(2), pp.367–392.
- Al-Ajmi, J., (2009). Audit firm, corporate governance, and audit quality: Evidence from Bahrain. *Advances in Accounting*, 25(1), pp.64–74.
- Al-Ajmi, J. & Hussain, H.A., (2011). Corporate dividends decisions: evidence from Saudi Arabia. *The Journal of Risk Finance*, 12(1), pp.41–56.
- Al-Bassam, W.M., Ntim, C.G., Opong, K.K. & Downs, Y., (2018). Corporate Boards and Ownership Structure as Antecedents of Corporate Governance Disclosure in Saudi Arabian Publicly Listed Corporations. *Business and Society*, 57(2), pp.335–377.
- Al-Fahad, A., (2005). Ornamental constitutionalism: the Saudi basic law of governance. *Yale Journal of International Law*, 30, pp.375–396.

- Al-Gharaibeh, M., (2013). The Effect of Ownership Structure on Dividends Policy in Jordanian Companies. *Interdisciplinary Journal of Contemporary Research in Business*, 4(9), pp.769–796.
- Al-Kuwari, D., (2009). Determinants of the dividend policy in emerging stock exchanges: The case of GCC countries. *Global Economy & Finance Journal*, 2(2), pp.38–63.
- Al-Najjar, B. & Hussainey, K., (2009). The association between dividend payout and outside directorships. *Journal of Applied Accounting Research*, 10(1), pp.4–19.
- Al-Najjar, B. & Kilincarslan, E., (2016). The effect of ownership structure on dividend policy: evidence from Turkey. *Corporate Governance: The international journal of business in society*, 16(1), pp.135–161.
- Al-Nodel, A. & Hussainey, K., (2010). Corporate Governance and Financing Decisions by Saudi Companies. *Journal of Modern Accounting and Auditing*, 6(8), pp.1–14.
- Al-Rasheed, M., (2010). *A History of Saudi Arabia* 2nd Editio., Cambridge University Press: Cambridge.
- Al-Rassas, A.H. & Kamardin, H., (2016). Earnings Quality and Audit Attributes in High Concentrated Ownership Market. *Corporate Governance: The international journal of business in society*, 16(2)
- Al-Twaijry, A.A.M., Brierley, J.A. & Gwilliam, D.R., (2002). An Examination of the Role of Audit Committees in the Saudi Arabian Corporate Sector. *Corporate Governance: An International Review*, 10(4), pp.288–297.
- Al-Twaijry, A. a. M., Brierley, J. a. & Gwilliam, D.R., (2004). An Examination of the Relationship Between Internal and External Audit in the Saudi Arabian Corporate Sector. *Managerial Auditing Journal*, 19(7), pp.929–944.
- Alamri, M., (2014). *Corporate Governance and the Board of Directors in Saudi-listed Companies*. PhD Thesis - University of Dundee.
- Ali, A.J., (2009). Conducting business in Saudi Arabia: A brief for international managers. *Global Business and Organizational Excellence*, 28(6), pp.64–84.
- Ali, A.J., (2005). *Islamic Perspectives On Management And Organization*, Edward Elgar Publishing.
- Ali, A.J., (1990). Management Theory in a Transitional Society: the Arab's Experience. *International Studies of Management & Organization*, 20(3), pp.7–35.
- Ali, A.J., Al-Aali, A. & Al-Owaihan, A., (2017). Islamic Perspectives on Profit Maximization. *Journal of Business Ethics*, 117(3), pp.467–475.
- Ali, C. Ben, Boubaker, S. & Magnan, M., (2014). Auditors and Principal-Principal Agency Conflicts in Family-controlled Firms. *Working Paper*
- Almajid, F.M., (2008). *A Conceptual Framework for Reforming the Corporate Governance of Saudi Publicly Held Companies: a Comparative and Analytical Study from a Legal Perspective*. PhD Thesis - University of Manchester.
- Alsanosi, M.T., (2010). *Corporate governance: the Saudi Arabian capital market*

- and international standards. PhD Thesis - University of Leicester.
- Alshehri, A., (2012). *An Investigation into the Evolution of CG and Accountability in SA*. PhD Thesis - King's College London.
- Anderson, R. & Reeb, D., (2004). Board composition: Balancing family influence in S&P 500 firms. *Administrative Science Quarterly*, 49(2), pp.209–237.
- Anderson, R. & Reeb, D., (2003). Founding family ownership and firm performance: evidence from the S&P 500. *The journal of finance*, LVIII(3), pp.1301–1328.
- Andres, C., (2011). Family ownership, financing constraints and investment decisions. *Applied Financial Economics*, 21(22), pp.1641–1659.
- Arsad, S., Ahmad, R., Nazjmi, W., Fisol, M., Said, R. & Haji-othman, Y., (2015). Maqasid Shariah in Corporate Social Responsibility of Shari'ah Compliant Companies. *Research Journal of Finance and Accounting*, 6(6), pp.239–248.
- Asquith, P. & Mullins, D., (1986). Equity Issues and Offering Dilution. *Journal of Financial Economics*, 15(1–2), pp.61–89.
- Attig, N., Ghouli, S. El & Guedhami, O., (2009). Do multiple large shareholders play a corporate governance role? Evidence from East Asia. *Journal of Financial Research*, XXXII(4), pp.395–422.
- Attig, N., Guedhami, O. & Mishra, D., (2008). Multiple large shareholders, control contests, and implied cost of equity. *Journal of Corporate Finance*, 14(5), pp.721–737.
- Azid, T., Asutay, M. & Burki, U., (2007). Theory of the Firm, Management and Stakeholders: An Islamic Perspective. *Islamic Economic Studies*, 15(1), pp.1–30.
- Baglioni, A. & Colombo, L., (2013). The efficiency view of corporate boards: theory and evidence. *Applied Economics*, 45(4), pp.497–510.
- Bahrawe, S.H., Haron, H. & Hasan, A.N. Bin, (2016). Corporate Governance and Auditor Independence in Saudi Arabia: Literature Review and Proposed Conceptual Framework. *International Business Research*, 9(11), pp.1–15.
- Baker, H., Powell, G. & Veit, E., (2002). Revisiting the dividend puzzle: Do all of the pieces now fit? *Review of Financial Economics*, 11, pp.241–261.
- Bammens, Y., Voordeckers, W. & Van Gils, A., (2011). Boards of Directors in Family Businesses: A Literature Review and Research Agenda. *International Journal of Management Reviews*, 13(2), pp.134–152.
- Barclay, M. & Holderness, C., (1989). Private benefits from control of public corporations. *Journal of financial Economics*, 25(2), pp.371–395.
- Barclay, M.J., Holderness, C.G. & Sheehan, D.P., (2009). Dividends and corporate shareholders. *Review of Financial Studies*, 22(6), pp.2423–2455.
- Barroso Casado, R., Burkert, M., Dávila, A. & Oyon, D., (2016). Shareholder Protection: The Role of Multiple Large Shareholders. *Corporate Governance: An International Review*, 24(2), pp.105–129. Available at: <http://doi.wiley.com/10.1111/corg.12131>.
- Beattie, V., Goodacre, A., Pratt, K. & Stevenson, J., (2001). The determinants of

- audit fees—evidence from the voluntary sector. *Accounting and Business Research*, 31(4), pp.243–274.
- Bebchuk, L.A., Kraakman, R. & Triantis, G., (2000). Stock pyramids, cross-ownership, and dual class equity: the mechanisms and agency costs of separating control from cash-flow rights. In *Concentrated corporate ownership*. pp. 295–318
- Becker, B., Cronqvist, H. & Fahlenbrach, R., (2011). Estimating the Effects of Large Shareholders Using a Geographic Instrument. *Journal of Financial and Quantitative Analysis*, 46(4), pp.907–942.
- Bedoui, H.E. & Mansour, W., (2015). Performance and Maqasid al-Shari'ah's Pentagon-Shaped Ethical Measurement. *Science and engineering ethics*, 21(3), pp.555–576.
- Beekun, R.I. & Badawi, J. a., (2005). Balancing Ethical Responsibility among Multiple Organizational Stakeholders: The Islamic Perspective. *Journal of Business Ethics*, 60(2), pp.131–145.
- Ben-Amar, W., Francoeur, C., Hafsi, T. & Labelle, R., (2013). What Makes Better Boards? A Closer Look at Diversity and Ownership. *British Journal of Management*, 24(1), pp.85–101.
- Di Benedetta, P. & Berg, A., (2009). *Corporate Governance Country Assessment: Kingdom of Saudi Arabia*, Report on the Observance of Standards and Codes (ROSC), The World Bank
- Benjamin, S.J., Mohamed, Z. Bin & Marathamuthu, M.S., (2015). Institutional Shareholders and Dividend Payout in Malaysia. *Corporate Ownership and Control*, 12(2), pp.329–343.
- Bennedsen, M. & Nielsen, K., (2010). Incentive and entrenchment effects in European ownership. *Journal of Banking & Finance*, 34(9), pp.2212–2229.
- Berkman, H., Cole, R.A. & Fu, L.J., (2010). Political Connections and Minority-Shareholder Protection: Evidence from Securities-Market Regulation in China. *Journal of Financial & Quantitative Analysis*, 45(6), pp.1391–1417.
- Bezemer, P., Peij, S., Kruijs, L. & Maassen, G., (2014). How two-tier boards can be more effective. *Corporate Governance*, 14(1), pp.15–31.
- Bishara, N.D., (2011). Governance and Corruption Constraints in the Middle East: Overcoming the Business Ethics Glass Ceiling. *American Business Law Journal*, 48(2), pp.227–283.
- Bjerke, B. & Al-Meer, A., (1993). Culture's Consequences: Management in Saudi Arabia. *Leadership & Organization Development Journal*, 14(2), pp.30–35.
- Bloomberg, (2015). Tadawul All Share TASI Index. Available at: <http://www.bloomberg.com/quote/SASEIDX:IND> [Accessed December 30, 2015].
- Bona-Sánchez, C., Pérez-Alemán, J. & Santana-Martín, D.J., (2014). Politically Connected Firms and Earnings Informativeness in the Controlling versus Minority Shareholders Context: European Evidence. *Corporate Governance: An International Review*, 22(4), pp.330–346.

- Boone, A.L., Casares Field, L., Karpoff, J.M. & Raheja, C.G., (2007). The determinants of corporate board size and composition: An empirical analysis. *Journal of Financial Economics*, 85(1), pp.66–101.
- Boubaker, S., Cellier, A. & Rouatbi, W., (2014). The sources of shareholder wealth gains from going private transactions: The role of controlling shareholders. *Journal of Banking & Finance*, 43, pp.226–246.
- Boubaker, S. & Sami, H., (2011). Multiple large shareholders and earnings informativeness. *Review of Accounting and Finance*, 10(3), pp.246–266.
- Bowen, W., (2008). *The History of Saudi Arabia*, Greenwood Press: Westport.
- Boyd, B.K. & Solarino, A.M., (2016). Ownership of Corporations: A Review, Synthesis, and Research Agenda. *Journal of Management*, 42(5), pp.1282–1314.
- Bradford, W., Chen, C. & Zhu, S., (2013). Cash dividend policy, corporate pyramids, and ownership structure: Evidence from China. *International Review of Economics and Finance*, 27, pp.445–464.
- Brown, P., Beekes, W. & Verhoeven, P., (2011). Corporate governance, accounting and finance: A review. *Accounting & finance*, 51(1), pp.96–172.
- Bukhari, M., (2014). *The Impact of Institutions on the Development of Corporate Governance in Saudi Arabia*. PhD Thesis - University of Nottingham.
- Burrell, G. & Morgan, G., (1979). *Sociological Paradigms and organisational Analysis - Elements of the Sociology of Corporate Life*, Heinemann Educational Books Ltd: London.
- Cadbury, A., (1992). *Report of the committee on the financial aspects of corporate governance*, Gee: London
- Cai, C.X., Hillier, D. & Wang, J., (2016). The Cost of Multiple Large Shareholders. *Financial Management*, 45(2), pp.401–430.
- Carcello, J. V. & Neal, T.L., (2003). Audit committee characteristics and auditor dismissals following “new” going-concern reports. *Accounting Review*, 78(1), pp.95–117.
- Cassell, M. & Blake, R., (2012). Analysis Of Hofstede’s 5-D Model: The Implications Of Conducting Business In Saudi Arabia. *International Journal of Management and Information Systems*, 16(2), pp.151–160.
- Chahine, S. & Tohmé, N.S., (2009). Is CEO Duality Always Negative? An Exploration of CEO Duality and Ownership Structure in the Arab IPO Context. *Corporate Governance: An International Review*, 17(2), pp.123–141.
- Chaney, P.K., Faccio, M. & Parsley, D., (2011). The quality of accounting information in politically connected firms. *Journal of Accounting and Economics*, 51(1–2), pp.58–76.
- Chang, S., (2003). Ownership Structure, Expropriation, and Performance of Group-Affiliated Companies in Korea. *Academy of Management Journal*, 46(2), pp.238–253.
- Chapra, M.U. & Ahmed, H., (2002). *Corporate Governance in Islamic Financial Institutions*, OECD Publishing.

- Chau, G. & Leung, P., (2006). The impact of board composition and family ownership on audit committee formation: Evidence from Hong Kong. *Journal of International Accounting, Auditing and Taxation*, 15(1), pp.1–15.
- Chazi, A., Boubakri, N. & Zanella, F., (2011). Corporate dividend policy in practice: Evidence from an emerging market with a tax-free environment. *Pacific-Basin Finance Journal*, 19(2), pp.245–259.
- Cheffins, B.R., (2008). *Corporate ownership and control: British business transformed*, Oxford.
- Chen, C.H. & Al-Najjar, B., (2012). The determinants of board size and independence: Evidence from China. *International Business Review*, 21(5), pp.831–846.
- Chen, J.C. & Roberts, R.W., (2010). Toward a More Coherent Understanding of the Organization–Society Relationship: A Theoretical Consideration for Social and Environmental Accounting Research. *Journal of Business Ethics*, 97(4), pp.651–665.
- Chen, K.Y. & Zhou, J., (2007). Audit Committee, Board Characteristics, and Auditor Switch Decisions by Andersen's Clients. *Contemporary Accounting Research*, 24(4), pp.1085–1117.
- Chen, Z., Cheung, Y.-L., Stouraitis, A. & Wong, A.W.S., (2005). Ownership concentration, firm performance, and dividend policy in Hong Kong. *Pacific-Basin Finance Journal*, 13(4), pp.431–449.
- Chizema, A. & Kim, J., (2010). Outside Directors on Korean Boards: Governance and Institutions. *Journal of Management Studies*, 47(1), pp.109–129.
- Choi, J. & Wong, T., (2007). Auditors' Governance Functions and Legal Environments: An International Investigation. *Contemporary Accounting Research*, 24(1), pp.13–46.
- Choudhury, M.A. & Hoque, M.Z., (2006). Corporate governance in Islamic perspective. *Corporate Governance*, 6(2), pp.116–128.
- Christopher, J., (2010). Corporate governance—A multi-theoretical approach to recognizing the wider influencing forces impacting on organizations. *Critical Perspectives on Accounting*, 21(8), pp.683–695.
- CIA, (2014). The World Factbook. Available at: <https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html>.
- Claessens, S., Djankov, S., Fan, J. & Lang, L., (2002). Disentangling the incentive and entrenchment effects of large shareholdings. *The Journal of Finance*, LVII(6), pp.2741–2771.
- Claessens, S., Djankov, S. & Lang, L., (2000). The separation of ownership and control in East Asian corporations. *Journal of financial Economics*, 58, pp.81–112.
- Claessens, S., Feijen, E. & Laeven, L., (2008). Political connections and preferential access to finance: The role of campaign contributions. *Journal of Financial Economics*, 88(3), pp.554–580.

- Clarke, P., Crawford, C., Steele, F. & Vignoles, A., (2015). Revisiting fixed- and random-effects models: some considerations for policy-relevant education research. *Education Economics*, 23(3), pp.259–277.
- CMA, (2016). CMA Announcement from the Capital Market Authority regarding the decision issued by The Committee for the Resolution of Securities Disputes (CRSD) to convict violators of the Capital Market Law and its implementing regulations: Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_2073.aspx.
- CMA, (2014). CMA Announcement in Regard to the Rules for Qualified Foreign Financial Institutions' Investment in Listed Shares. Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_1506.aspx.
- CMA, (2015a). CMA Announcement in Regards to the Suspension of Trading the Shares of Etihad Etisalat Co. (Mobily). Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_1801.aspx.
- CMA, (2012). CMA Announcement Regarding the Suspension of Trading Securities. Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_1178.aspx.
- CMA, (2015b). CMA Announcement to lift the suspension of trading the shares of Etihad Etisalat Co. (Mobily). Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_1686.aspx.
- CMA, (2015c). CMA Announcement to lift the suspension of trading the shares of Etihad Etisalat Co. (Mobily). Available at:
http://www.cma.org.sa/En/News/Pages/CMA_N_1840.aspx.
- CMA, (2010). *Corporate Governance Regulation*, The Board of Capital Market Authority: www.cma.org.sa
- Cohen, J., Krishnamoorthy, G. & Wright, A.M., (2002). Corporate Governance and the Audit Process. *Contemporary Accounting Research*, 19(4), pp.573–594.
- Coles, J., Daniel, N. & Naveen, L., (2008). Boards: Does one size fit all? *Journal of Financial Economics*, 87(2), pp.329–356.
- Collis, J. & Hussey, R., (2009). *Business research : a practical guide for undergraduate and postgraduate students* 3rd ed., Palgrave Macmillan: Houndmills.
- Connelly, B.L., Hoskisson, R.E., Tihanyi, L. & Certo, S.T., (2010). Ownership as a Form of Corporate Governance. *Journal of Management Studies*, 47(8), pp.1561–1589.
- Copley, P. a & Douthett Jr., E.B., (2002). The Association between Auditor Choice, Ownership Retained, and Earnings Disclosure by Firms Making Initial Public Offerings. *Contemporary Accounting Research*, 19(1), pp.49–75.
- Craswell, A.T., Francis, J.R. & Taylora, S.L., (1995). Auditor brand name reputations and industry Specializations. *Journal of Accounting and Economics*, 20(3), pp.297–322.
- Crockett, J. & Friend, I., (1988). Dividend Policy In Perspective: Can Theory Explain Behavior? *he Review of Economics and Statistics*, 70(4), p.25.

- Cronqvist, H. & Fahlenbrach, R., (2009). Large Shareholders and Corporate Policies. *Review of Financial Studies*, 22(10), pp.3941–3976.
- Crutchley, C. & Hansen, R., (1989). A Test of the Agency Theory of Managerial Ownership, Corporate Leverage, and Corporate Dividends. *Financial Management*, 18(4), pp.36–46.
- Daily, C., Dalton, D. & Cannella, A., (2003). Corporate Governance: Decades of Dialogue and Data. *Academy of Management Review*, 28(3), pp.371–382.
- Daily, C., Dalton, D. & Rajagopalan, N., (2003). Governance Through Ownership: Centuries of Practice, Decades of Research. *Academy of Management Journal*, 46(2), pp.151–158.
- Dalton, D.R., Hitt, M. a., Certo, S.T. & Dalton, C.M., (2007). The Fundamental Agency Problem and Its Mitigation. *The Academy of Management Annals*, 1(1), pp.1–64.
- Datar, S.M., Feltham, G. a & Hughes, J.S., (1991). The role of audits and audit quality in valuing new issues. *Journal of Accounting and Economics*, 14(1), pp.3–49.
- Davis, J.H., Schoorman, F.D. & Donaldson, L., (1997). Toward a Stewardship Theory of Management. *The Academy of Management Review*, 22(1), p.20.
- DeAngelo, L., (1981). Auditor Size and Audit Quality. *Journal of accounting and economics*, 3(3), pp.183–199.
- DeFond, M. & Zhang, J., (2014). A review of archival auditing research. *Journal of Accounting and Economics*, 58(2–3), pp.275–326.
- Demsetz, H. & Villalonga, B., (2001). Ownership structure and corporate performance. *Journal of Corporate Finance*, 7(3), pp.209–233.
- Denis, D. & McConnell, J., (2003). International corporate governance. *Journal of Financial and Quantitative Analysis*, 38(1), pp.1–36.
- Denis, D. & Osobov, I., (2008). Why do firms pay dividends? International evidence on the determinants of dividend policy. *Journal of Financial Economics*, 89(1), pp.62–82.
- Desender, K., Aguilera, R., Crespi, R. & Garcia-Centona, M., (2013). When does ownership matter? Board characteristics and behavior. *Strategic Management Journal*, 34, pp.823–842.
- Dharwadkar, R., George, G. & Brandes, P., (2000). Privatization in Emerging Economies: An Agency Theory Perspective. *Academy of Management Review*, 25(3), pp.650–669.
- Ding, S., Jia, C., Wu, Z. & Zhang, X., (2014). Executive political connections and firm performance: Comparative evidence from privately-controlled and state-owned enterprises. *International Review of Financial Analysis*, 36(153–167)
- Djankov, S., La Porta, R., Lopez-de-Silanes, F. & Shleifer, A., (2008). The law and economics of self-dealing. *Journal of Financial Economics*, 88(3), pp.430–465.
- Djebali, R. & Belanès, A., (2015). On The Impact Of Family Versus Institutional

- Blockholders On Dividend Policy. *The Journal of Applied Business Research*, 31(4), pp.1329–1342.
- Donnelly, R. & Kelly, P., (2005). Ownership and Board Structures in Irish plcs. *European Management Journal*, 23(6), pp.730–740.
- Douma, S., George, R. & Kabir, R., (2006). Foreign and domestic ownership, business groups, and firm performance: evidence from a large emerging market. *Strategic Management Journal*, 27(7), pp.637–657.
- Durisin, B. & Puzone, F., (2009). Maturation of Corporate Governance Research, 1993-2007: An Assessment. *Corporate Governance: An International Review*, 17(3), pp.266–291.
- Dyck, A. & Zingales, L., (2004). Private benefits of control: An international comparison. *The Journal of Finance*, 59(2), pp.537–600.
- Easterbrook, F., (1984). Two Agency-Cost Explanations of Dividends. *The American Economic Review*, 74(4), pp.650–659.
- Edmans, A., (2014). Blockholders and Corporate Governance. *Annual Review of Financial Economics*, 6(1), pp.23–50.
- Edmans, A. & Holderness, C.G., (2016). Blockholders : A Survey of Theory and Evidence. *ECGI-Finance Working Paper*, 475/2016
- Edmans, A. & Manso, G., (2009). *Governance Through Exit and Voice : A Theory of Multiple Blockholders*,
- Edmans, A. & Manso, G., (2011). Governance Through Trading and Intervention: A Theory of Multiple Blockholders. *Review of Financial Studies*, 24(7), pp.2395–2428.
- van Essen, M., Carney, M., Gedajlovic, E. & Heugens, P., (2015). How does family control influence firm strategy and performance? A meta-analysis of US publicly-listed firms. *Corporate Governance: An International Review*, 23(1), pp.3–25.
- Faccio, M., (2010). Differences between Politically Connected and Nonconnected Firms: A Cross-Country Analysis. *Financial Management*, 39(3), pp.905–928.
- Faccio, M., (2006). Politically connected firms. *The American Economic Review*, 96(1), pp.369–386.
- Faccio, M., (2007). *The characteristics of politically connected firms*, Purdue CIBER Working Papers. Paper 51
- Faccio, M. & Lang, L., (2002). The ultimate ownership of Western European Corporations. *Journal of Financial Economics*, 65(3), pp.365–395.
- Faccio, M., Lang, L. & Young, L., (2001). Dividends and Expropriation. *American Economic Review*, 91(1), pp.54–78.
- Faccio, M., Masulis, R. & McConnell, J., (2006). Political connections and corporate bailouts. *The Journal of Finance*, 61(6), pp.2597–2635.
- Falgi, K.I., (2009). *Corporate Governance in Saudi Arabia: A Stakeholder Perspective*. PhD Thesis - University of Dundee.
- Fallatah, Y. & Dickins, D., (2012). Corporate governance and firm performance

- and value in Saudi Arabia. *African Journal of Business Management*, 6(36), pp.10025–10034.
- Fama, E., (1980). Agency Problems and the Theory of the Firm. *The Journal of Political Economy*, 88(2), pp.288–307.
- Fama, E. & Jensen, M., (1983). Separation of Ownership and Control. *Journal of Law & Economics*, 26(6), pp.301–325.
- Fan, J. & Wong, T., (2005). Do External Auditors Perform a Corporate Governance Role in Emerging Markets? Evidence from East Asia. *Journal of Accounting Research*, 43(1), pp.35–72.
- Fan, J., Wong, T. & Zhang, T., (2007). Politically connected CEOs, corporate governance, and Post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, 84(2), pp.330–357.
- Farinha, J., (2003). Dividend policy, corporate governance and the managerial entrenchment hypothesis: an empirical analysis. *Journal of Business Finance & Accounting*, 30(9), pp.1173–1209.
- Farooq, O. & Tabine, S., (2015). Agency Problems and the Choice of Auditors: Evidence from the MENA Region. *Review of Middle East Economics and Finance*, 11(1), pp.79–97.
- Febianto, I., (2011). Shariah Compliant Model of Business Entities. *World Journal of Social Sciences*, 1(4), pp.130–149.
- Feldmann, D. a. & Schwarzkopf, D.L., (2003). The Effect of Institutional Ownership on Board and Audit Committee Composition. *Review of Accounting and Finance*, 2(4), pp.87–109.
- Fox, M. & Hamilton, R., (1994). Ownership and diversification: Agency theory or stewardship theory. *Journal of Management Studies*, 31(1), pp.69–81.
- Fraile, I. & Fradejas, N., (2014). Ownership structure and board composition in a high ownership concentration context. *European Management Journal*, 32(4), pp.646–657.
- Francis, J.R., (2004). What do we know about audit quality? *British Accounting Review*, 36(4), pp.345–368.
- Frankfurter, G. & Wood, B., (2003). *Dividend policy: Theory and practice*, Academic Press: San Diego.
- Frankfurter, G. & Wood, B., (2002). Dividend policy theories and their empirical tests. *International Review of Financial Analysis*, 11(2), pp.111–138.
- Freeman, R.E. & Reed, D.L., (1983). Stockholders and Stakeholders: A New Perspective on Corporate Governance. *California Management Review*, 25(3), pp.88–106.
- García-Sánchez, I.M., Frias-Aceituno, J. V. & Garcia-Rubio, R., (2012). Determining Factors of Audit Committee Attributes: Evidence from Spain. *International Journal of Auditing*, 16(2), pp.184–213.
- Gaur, S.S., Bathula, H. & Singh, D., (2015). Ownership concentration, board characteristics and firm performance A contingency framework. *Management Decision*, 53(5), pp.911–931.

- El Ghouli, S., Guedhami, O., Lennox, C. & Pittman, J., (2015). External versus Internal Monitoring: The Importance of Multiple Large Shareholders and Families to Auditor Choice in Western European Firms. *working paper* Available at: <http://ssrn.com/abstract=1373808>.
- Gillan, S., (2006). Recent developments in corporate governance: an overview. *Journal of corporate finance*, 12(3), pp.381–402.
- Gioia, D.A. & Pitre, E., (1990). Multiparadigm Perspectives on Theory Building. *Academy of Management Review*, 15(4), pp.584–602.
- Gippel, J., Smith, T. & Zhu, Y., (2015). Endogeneity in Accounting and Finance Research: Natural Experiments as a State-of-the-Art Solution. *A Journal of Accounting, Finance and Business Studies*, 51(2), pp.1–26.
- Goergen, M. & Renneboog, L., (2001). Investment policy, internal financing and ownership concentration in the UK. *Journal of Corporate Finance*, 7(3), pp.257–284.
- Gonzalez, M., Guzman, A., Pombo, C. & Trujillo, M.-A., (2014). Family Involvement and Dividend Policy in Closely Held Firms. *Family Business Review*, 27(4), pp.365–385.
- Grossman, S. & Hart, O., (1980). Takeover bids, the free-rider problem, and the theory of the corporation. *The Bell Journal of Economics*, 11(1), pp.42–64.
- Grout, P.A., Megginson, W.L. & Zalewska, A., (2009). *One Half-Billion Shareholders and Counting : Determinants of Individual Share Ownership around the World*, Available at: <http://ssrn.com/abstract=1364765>.
- Guedhami, O., Pittman, J.A. & Saffar, W., (2014). Auditor choice in politically connected firms. *Journal of Accounting Research*, 52(1), pp.107–162.
- Guedhami, O., Pittman, J. a & Saffar, W., (2009). Auditor choice in privatized firms: Empirical evidence on the role of state and foreign owners. *Journal of Accounting and Economics*, 48(2–3), pp.151–171.
- Guest, P.M., (2008). The determinants of board size and composition: Evidence from the UK. *Journal of Corporate Finance*, 14(1), pp.51–72.
- Gugler, K., (2003). Corporate governance, dividend payout policy, and the interrelation between dividends, R&D, and capital investment. *Journal of Banking and Finance*, 27(7), pp.1297–1321.
- Gugler, K. & Yurtoglu, B.B., (2003). Corporate governance and dividend pay-out policy in Germany. *European Economic Review*, 47(4), pp.731–758.
- Gujarati, D., (2003). *Basic Econometrics* 4th ed., McGraw Hill: Boston.
- Gul, F. a, (1999). Government share ownership, investment opportunity set and corporate policy choices in China. *Pacific-Basin Finance Journal*, pp.157–172.
- Guthrie, K. & Sokolowsky, J., (2010). Large shareholders and the pressure to manage earnings. *Journal of Corporate Finance*, 16(3), pp.302–319.
- Habib, A., Muhammadi, A.H. & Jiang, H., (2017). Political Connections, Related Party Transactions, and Auditor Choice: Evidence from Indonesia. *Journal of Contemporary Accounting & Economics*, 13(1), pp.1–19.
- Hair, J.F.J., Black, W.C., Babin, B.J. & Anderson, R.E., (2010). *Multivariate data*

- analysis: A global perspective* 7th ed., Pearson Prentice Hall: Upper Saddle River, New Jersey.
- Haniffa, R. & Hudaib, M., (2006). Corporate Governance Structure and Performance of Malaysian Listed Companies. *Journal of Business Finance & Accounting*, 33(7–8), pp.1034–1062.
- Haniffa, R. & Hudaib, M., (2007). Locating audit expectations gap within a cultural context: The case of Saudi Arabia. *Journal of International Accounting, Auditing and Taxation*, 16(2), pp.179–206.
- Hasan, Z., (2009). Corporate Governance : Western and Islamic Perspectives. *International Review of Business Research Papers*, 5(1), pp.277–293.
- Hasan, Z., (2011). *Shari'ah Governance in Islamic Financial Institutions in Malaysia, GCC Countries and the UK*. PhD Thesis, Durham University.
- Hassan, H., Abd Ghadas, Z. & Abdul Rahman, N., (2012). “ The Myth of Corporate Personality ”: A comparative Legal Analysis of the Doctrine of Corporate Personality of Malaysian and Islamic Laws. *Australian Journal of Basic and Applied Sciences*, 6(11), pp.191–198.
- Hawkamah & IFC, (2008). *A Corporate Governance Survey of Listed Companies and Banks A Cross the Middle East & North Africa*,
- Healy, P.M. & Palepu, K.G., (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics*, 31(1–3), pp.405–440.
- Hermalin, B. & Weisbach, M., (1998). Endogenously chosen boards of directors and their monitoring of the CEO. *American Economic Review*, 88(1), pp.96–118.
- Hillman, A., Cannella, A.J. & Paetzold, R., (2000). The resource dependence role of corporate directors: strategic adaptation of board composition in response to environmental change. *Journal of Management Studies*, 37(2), pp.235–256.
- Hillman, A. & Dalziel, T., (2003). Boards of directors and firm performance: Integrating agency and resource dependence perspectives. *The Academy of Management Review*, 28(3), pp.383–396.
- Hillman, A.J., Nicholson, G. & Shropshire, C., (2008). Directors' Multiple Identities, Identification, and Board Monitoring and Resource Provision. *Organization Science*, 19(3), pp.441–456.
- Hillman, A.J., Withers, M.C. & Collins, B.J., (2009). Resource Dependence Theory: A Review. *Journal of Management*, 35(6), pp.1404–1427.
- Ho, J.L. & Kang, F., (2013). Auditor Choice and Audit Fees in Family Firms : Evidence from the S&P 1500. *AUDITING: A Journal of Practice & Theory*, 32(4), pp.71–93.
- Holder, M.E., Langrehr, F.W. & Hexter, J.L., (1998). Dividend policy determinants: An investigation of the influences of stakeholder theory. *Financial Management*, 27(3), pp.73–82.
- Holderness, C., (2003). A Survey of Blockholders and Corporate Control. *FRB New*

- York - Economic Policy Review*, 9(1), pp.51–64.
- Holderness, C., (2010). Blockholders Are More Common in the United States Than You Might Think. *Journal of Applied Corporate Finance*, 22(4), pp.75–85.
- Holderness, C., (2007). The Myth of Diffuse Ownership in the United States. *Review of Financial Studies*, 22(4), pp.1377–1408.
- Holderness, C. & Sheehan, D., (1988). The Role of Majority Shareholders in Publicly Held Corporations : An Exploratory Analysis. *Journal of financial economics*, 20, pp.317–346.
- Hoskisson, R., Hitt, M., Johnson, R. & Grossman, W., (2002). Conflicting Voices: The Effects of Institutional Ownership Heterogeneity and Internal Governance on Corporate Innovation Strategies. *Academy of Management Journal*, 45(4), pp.697–716.
- Huse, M., (2007). Boards, Governance and Value Creation.
- Huyghebaert, N. & Wang, L., (2012). Expropriation of Minority Investors in Chinese Listed Firms: The Role of Internal and External Corporate Governance Mechanisms. *Corporate Governance: An International Review*, 20(3), pp.308–332.
- IISS, (2000). Saudi Arabia's royal council. *Strategic Comments*, 6(7), pp.1–2.
- Iqbal, Z. & Lewis, M.K., (2009). *An Islamic perspective on governance*, Cheltenham, UK : Edward Elgar.
- Iqbal, Z. & Mirakhor, A., (2004). Stakeholder Model of Governance in Islamic Economic System. *Islamic Economic Studies*, 11(2), pp.43–63.
- Jaggi, B. & Leung, S., (2007). Impact of family dominance on monitoring of earnings management by audit committees: Evidence from Hong Kong. *Journal of International Accounting, Auditing and Taxation*, 16(1), pp.27–50.
- Jara-Bertin, M., López-Iturriaga, F.J. & López-de-Foronda, Ó., (2008). The Contest to the Control in European Family Firms: How Other Shareholders Affect Firm Value. *Corporate Governance: An International Review*, 16(3), pp.146–159.
- Jensen, G., Solberg, D. & Zorn, T., (1992). Simultaneous Determination of Insider Ownership, Debt, and Dividend Policies. *The Journal of Financial and Quantitative Analysis*, 27(2), pp.247–263.
- Jensen, M., (1986). Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers. *The American economic review*, 76(2), pp.323–329.
- Jensen, M. & Meckling, W., (1976). Theory of the Firm: managerial behaviour, agency costs and ownership structure. *Journal of financial economics*, 3, pp.305–360.
- Jiang, G., Lee, C.C. & Yue, H., (2010). Tunneling through intercorporate loans: The China experience. *Journal of Financial Economics*, 98(1), pp.1–20.
- Jiang, H., Habib, A. & Hu, B., (2011). Ownership concentration, voluntary disclosures and information asymmetry in New Zealand. *The British Accounting Review*, 43(1), pp.39–53.

- Johnson, J., Daily, C. & Ellstrand, A., (1996). Boards of Directors: A Review and Research Agenda. *Journal of Management*, 22(3), pp.409–438.
- Jones, S., (2013). The Mirage of the Arab Spring. *Foreign Affairs*, 92(1), pp.55–63.
- Al Kahtani, F.S., (2014). Corporate Governance from the Islamic Perspective. *Arab Law Quarterly*, 28(3), pp.231–256.
- Kalcheva, I. & Lins, K., (2007). International Evidence on Cash Holdings and Expected Managerial Agency Problems. *Review of Financial Studies*, 20(4), pp.1087–1112.
- Kasri, R.A., (2009). Corporate Governance: Conventional Vs Islamic Perspective. *Universitas Indonesia, Jakarta*, pp.0–11.
- Keasey, K., Martinez, B. & Pindado, J., (2015). Young family firms: Financing decisions and the willingness to dilute control. *Journal of Corporate Finance*, 34, pp.47–63.
- Khan, A., Mihret, D.G. & Muttakin, M.B., (2016). Corporate Political Connections, Agency Costs and Audit Quality. *International Journal of Accounting & Information Management*, 24(4), pp.357–374.
- Khan, A., Muttakin, M.B. & Siddiqui, J., (2015). Audit fees, auditor choice and stakeholder influence: Evidence from a family-firm dominated economy. *The British Accounting Review*, 47(3), pp.304–320.
- Khan, A., Muttakin, M.B. & Siddiqui, J., (2013). Corporate Governance and Corporate Social Responsibility Disclosures: Evidence from an Emerging Economy. *Journal of Business Ethics*, 114(2), pp.207–223.
- Khan, T., (2006). Company Dividends and Ownership Structure: Evidence from UK Panel Data. *The Economic Journal*, 116(510), pp.172–189.
- Khwaja, A. & Mian, A., (2005). Do Lenders Favor Politically Connected Firms? Rent Provision in an Emerging Financial Market. *The Quarterly Journal of Economics*, 120(4), pp.1371–1411.
- Kim, K., (2010). Blockholder monitoring and the efficiency of pay-performance benchmarking. *Journal of Corporate Finance*, 16(5), pp.748–766.
- Kim, K. a., Kitsabunnarat-Chatjuthamard, P. & Nofsinger, J.R., (2007). Large shareholders, board independence, and minority shareholder rights: Evidence from Europe. *Journal of Corporate Finance*, 13(5), pp.859–880.
- Klein, A. & Zur, E., (2009). Entrepreneurial shareholder activism: Hedge funds and other private investors. *The Journal of Finance*, LXIV(1), pp.187–229.
- Koldertsova, A., (2010). The second corporate governance wave in the Middle East and North Africa. *OECD Journal: Financial Market Trends*, (2)
- Krishnan, J., (2005). Audit committee quality and internal control: An empirical analysis. *Accounting Review*, 80(2), pp.649–675.
- KSA, (2016). Saudi Vision 2030. Available at: vision2030.gov.sa/download/file/fid/417.
- Kumar, P. & Zattoni, A., (2014). Large shareholders and corporate governance outside the United States and United Kingdom. *Corporate Governance: An International Review*, 22(4), pp.294–295.

- Kutner, M., Nachtsheim, C. & Neter, J., (2004). *Applied Linear Regression Models* 4th ed., McGraw-Hill Irwin: Boston.
- Lasfer, M.A., (2006). The Interrelationship Between Managerial Ownership and Board Structure. *Journal of Business Finance & Accounting*, 33(7–8), pp.1006–1033.
- Lee, C., Liang, W., Lin, F. & Yang, Y., (2015). Applications of simultaneous equations in finance research: method and empirical results. *Review of Quantitative Finance and Accounting*, pp.1–29.
- Lei, A. & Lam, S., (2013). Family Ownership, Auditor Choice and Audit fees: Evidence from Hong Kong. *Seventh Asia Pacific Interdisciplinary Research in Accounting Conference*, Paper# K17
- Lennox, C., (1999). Are large auditors more accurate than small auditors? *Accounting and Business Research*, 29(3), pp.217–227.
- Lennox, C., (2005). Management Ownership and Audit Firm Size. *Contemporary Accounting Research*, 22(1), pp.205–227.
- Lessambo, F.I., (2014). *The International Corporate Governance System: Audit Roles and Board Oversight*, Basingstoke: Palgrave Macmillan.
- Leung, N.W. & Liu, J., (2015). Ownership structure and auditor choice: evidence from Chinese listed firms. *Asian Journal of Business Ethics*, 4(2), pp.163–185.
- Lewis, M.K., (2001). Islam and accounting. *Accounting Forum*, 25(2), pp.103–127.
- Lewis, M.K., (2005). Islamic Corporate Governance. *Review of Islamic Economics*, 9(1), pp.5–29.
- Li, J., (1994). Ownership structure and board composition: A multi-country test of agency theory predictions. *Managerial and Decision Economics*, 15(4), pp.359–368.
- Lin, Z.J. & Liu, M., (2009). The impact of corporate governance on auditor choice: Evidence from China. *Journal of International Accounting, Auditing and Taxation*, 18(1), pp.44–59.
- Linck, J., Netter, J. & Yang, T., (2008). The determinants of board structure. *Journal of Financial Economics*, 87(2), pp.308–328.
- Lintner, J., (1956). Distribution of Incomes of Corporations Among Dividends, Retained Earnings, and Taxes. *American Economic Review*, 46(2), pp.97–113.
- Liu, J., Wang, Y. & Wu, L., (2011). The Effect of Guanxi on Audit Quality in China. *Journal of Business Ethics*, 103(4), pp.621–638.
- Liu, Q., Luo, T. & Tian, G.G., (2015). Family control and corporate cash holdings : Evidence from China. *Journal of Corporate Finance*, 31, pp.220–245.
- Liu, Y., Li, X., Zeng, H. & An, Y., (2016). Political connections, auditor choice and corporate accounting transparency: Evidence from private sector firms in China. *Accounting and Finance*, In Press
- Long, D. & Maisel, S., (2010). *The Kingdom of Saudi Arabia* 2nd Editio., University Press of Florida: Gainesville.
- López-Iturriaga, F.J. & Santana-Martín, D.J., (2015). Do Shareholder Coalitions

- Modify the Dominant Owner's Control? The Impact on Dividend Policy. *Corporate Governance: An International Review*, 23(6), pp.519–533.
- Mak, Y.. & Li, Y., (2001). Determinants of corporate ownership and board structure: evidence from Singapore. *Journal of Corporate Finance*, 7(3), pp.235–256.
- Malik, M., (2014). Audit committee composition and effectiveness: a review of post-SOX literature. *Journal of Management Control*, 25(2), pp.81–117.
- Mancinelli, L. & Ozkan, A., (2006). Ownership Structure and Dividend Policy: Evidence from Italian Firms. *The European Journal of Finance*, 12(3), pp.265–282.
- Mansi, S. a., Maxwell, W.F. & Miller, D.P., (2004). Does Auditor Quality and Tenure Matter to Investors? Evidence from the Bond Market. *Journal of Accounting Research*, 42(4), pp.755–793.
- Mansour, W. & Bhatti, M.I., (2018). The new paradigm of Islamic corporate governance. *Managerial Finance*, In Press
- Mathew, S. & Khan, S., (2015). Etihad Etisalat Removes CEO as Errors Sink Market Value. *Bloomberg*, p.25/Feb/2015.
- Maury, B. & Pajuste, A., (2005). Multiple large shareholders and firm value. *Journal of Banking & Finance*, 29(7), pp.1813–1834.
- McConnell, J.J. & Servaes, H., (1990). Additional evidence on equity ownership and corporate value. *Journal of Financial Economics*, 27(2), pp.595–612.
- McKnight, P.J. & Weir, C., (2009). Agency costs, corporate governance mechanisms and ownership structure in large UK publicly quoted companies: A panel data analysis. *The Quarterly Review of Economics and Finance*, 49(2), pp.139–158.
- McNulty, T., Zattoni, A. & Douglas, T., (2013). Developing Corporate Governance Research through Qualitative Methods: A Review of Previous Studies. *Corporate Governance: An International Review*, 21(2), pp.183–198.
- Meggison, W. & Netter, J., (2001). From state to market: A survey of empirical studies on privatization. *Journal of economic literature*, 39(2), pp.321–389.
- De Miguel, A., Pindado, J. & De La Torre, C., (2004). Ownership structure and firm value: new evidence from Spain. *Strategic Management Journal*, 25(12), pp.1199–1207.
- Miller, M. & Rock, K., (1985). Dividend Policy under Asymmetric Information. *The Journal of Finance*, XL(4), pp.1031–1051.
- Miller, M.H. & Modigliani, F., (1961). Dividend Policy, Growth, and the Valuation of Shares. *The Journal of Business*, 34(4), p.411.
- Mishra, D.R., (2011). Multiple Large Shareholders and Corporate Risk Taking: Evidence from East Asia. *Corporate Governance: An International Review*, 19(6), pp.507–528.
- Modigliani, F. & Miller, M., (1958). The Cost of Capital, Corporate Finance and the Theory of Investment. *The American economic review*, 48(3), pp.261–297.
- Moizer, P., (1997). Auditor Reputation: The International Empirical Evidence.

- International Journal of Auditing*, 1(1), pp.61–74.
- Mollah, S. & Zaman, M., (2015). Shari'ah supervision, corporate governance and performance: Conventional vs. Islamic banks. *Journal of Banking and Finance*, 58, pp.418–435.
- Morck, R., Shleifer, A. & Vishny, R., (1988). Management ownership and market valuation: An empirical analysis. *Journal of financial economics*, 20, pp.293–315.
- Muneeza, A. & Hassan, R., (2014). Shari'ah corporate governance: the need for a special governance code. *Corporate Governance: The international journal of business in society*, 14(1), pp.120–129.
- Munisi, G., Hermes, N. & Randøy, T., (2014). Corporate boards and ownership structure: Evidence from Sub-Saharan Africa. *International Business Review*, 23(4), pp.785–796.
- Murphy, M.J. & Smolarski, J.M., (2018). Religion and CSR: An Islamic “Political” Model of Corporate Governance. *Business & Society*, In Press
- Naiker, V. & Sharma, D.S., (2009). Former audit partners on the audit committee and internal control deficiencies. *Accounting Review*, 84(2), pp.559–587.
- Niblock, T., (2006). *Saudi Arabia: Power, Legitimacy and Survival*, Routledge: Oxon.
- O'Sullivan, N., (2000). The Impact of Board Composition and Ownership on Audit Quality: Evidence From Large Uk Companies. *The British Accounting Review*, 32(4), pp.397–414.
- Al Omran, A., (2016). Saudi Stocks Regulator Penalizes Deloitte Unit After Tainted IPO. *Wall Street Journal*, p.20/June/2016.
- Osman, D. & Mohammed, E., (2010). Dividend Policy in Saudi Arabia. *International Journal of Business and Finance Research*, 4(1), pp.99–113.
- Pearce, J. & Zahra, S., (1992). Board composition from a strategic contingency perspective. *Journal of management studies*, 29(4), pp.411–438.
- Pfeffer, J. & Salancik, G., (1978). *The External Control of Organization: A resource dependence perspective*, New York: Haper & Row.
- Pierce, C., (2012). *Corporate Governance in the Gulf*, Kent: Global Governance Services Ltd.
- Piesse, J., Strange, R. & Toonsi, F., (2011). Is there a distinctive MENA model of corporate governance? *Journal of Management & Governance*, 16(4), pp.645–681.
- Pindado, J. & Requejo, I., (2015). Family Business Performance from a Governance Perspective: A Review of Empirical Research. *International Journal of Management Reviews*, 17(3), pp.279–311.
- Pindado, J., Requejo, I. & Torre, C., (2012). Do Family Firms Use Dividend Policy as a Governance Mechanism? Evidence from the Euro zone. *Corporate Governance: An International Review*, 20(5), pp.413–431.
- La Porta, R., Lopez-de-Silanes, F. & Shleifer, A., (1999). Corporate ownership around the world. *The journal of finance*, LIV(2), pp.471–517.

- La Porta, R., Lopez-de-silanes, F., Shleifer, A. & Vishny, R., (2000). Agency Problems and Dividend Policies around the World. *Journal of Finance*, 55(1), pp.1–33.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R., (2000). Investor protection and corporate governance. *Journal of Financial Economics*, 58(1–2), pp.3–27.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A. & Vishny, R., (1998). Law and finance. *Journal of Political Economy*, 106(6), pp.1113–1155.
- Quttainah, M. & Paczkowski, W., (2012). Corporate governance and initial public offerings in the Kingdom of Saudi Arabia. In A. Zattoni & W. Judge, eds. *Corporate Governance and Initial Public Offerings: An International Perspective*. Cambridge University Press: Cambridge., pp. 262–286
- Rainsbury, E.A., Bradbury, M. & Cahan, S.F., (2008). The impact of audit committee quality on financial reporting quality and audit fees. *Accounting and Business Research*, 38(5), pp.393–408.
- Ramady, M.A., (2007). Saudi Stock Market 2006: A Turbulent Year. *Arab News*
- Rashad, M. & Al Sayegh, H., (2015). MIDEAST MONEY-Saudi firms tighten controls in wake of Mobily scandal. *Reuters*, p.5/April/2015.
- Rediker, K. & Seth, A., (1995). Boards of directors and substitution effects of alternative governance mechanisms. *Strategic Management Journal*, 16(2), pp.85–99.
- Renders, A. & Gaeremynck, A., (2012). Corporate Governance, Principal-Principal Agency Conflicts, and Firm Value in European Listed Companies. *Corporate Governance: An International Review*, 20(2), pp.125–143.
- Rizk, R., (2008a). Back to Basics: An Islamic Perspective on Business and Work Ethics. *Social Responsibility Journal*, 4(1/2), pp.246–254.
- Rizk, R., (2008b). Islam and corporate governance. In G. Aras & D. Crowther, eds. *Culture and Corporate Governance*. The Social Responsibility Research Network: Yorkshire., pp. 204–215
- Rizk, R., (2014). Islamic Environmental Ethics. *Journal of Islamic Accounting and Business Research*, 5(2), pp.194–204.
- Robertson, C.J., Diyab, A. a. & Al-Kahtani, A., (2013). A cross-national analysis of perceptions of corporate governance principles. *International Business Review*, 22(1), pp.315–325.
- Rozeff, M., (1982). Growth, Beta and Agency Costs as Determinants of Dividend Payout Ratios. *Journal of financial Research*, 5(3), pp.249–259.
- Sacristán-Navarro, M., Cabeza-García, L. & Gómez-Ansón, S., (2015). The Company You Keep: The Effect of Other Large Shareholders in Family Firms. *Corporate Governance: An International Review*, 23(3), pp.216–233.
- Sáez, M. & Gutiérrez, M., (2015). Dividend Policy with Controlling Shareholders. *Theoretical Inquiries in Law*, 16(1), pp.107–130.
- Safieddine, A., (2009). Islamic Financial Institutions and Corporate Governance: New Insights for Agency Theory. *Corporate Governance: An International*

- Review*, 17(2), pp.142–158.
- Santos, A.O., (2015). Integrated Ownership and Control in the GCC Corporate Sector. *IMF Working Paper*, WP/15/184
- Saunders, M., Lewis, P. & Thornhill, A., (2008). *Research Methods for Business Students* 5th ed., Pearson Education Limited: Essex.
- Saunders, M., Lewis, P. & Thornhill, A., (2012). *Research Methods for Business Students* 6th ed., Essex: Pearson Education Limited.
- Setia-Atmaja, L., (2009). Governance Mechanisms and Firm Value: The Impact of Ownership Concentration and Dividends. *Corporate Governance: An International Review*, 17(6), pp.694–709.
- Setia-Atmaja, L., Haman, J. & Tanewski, G., (2011). The role of board independence in mitigating agency problem II in Australian family firms. *The British Accounting Review*, 43(3), pp.230–246.
- Setia-Atmaja, L., Tanewski, G. a. & Skully, M., (2009). The Role of Dividends, Debt and Board Structure in the Governance of Family Controlled Firms. *Journal of Business Finance & Accounting*, 36(7–8), pp.863–898.
- Shleifer, A. & Vishny, R., (1997). A survey of corporate governance. *The journal of finance*, LII(2), pp.737–783.
- Shleifer, A. & Vishny, R., (1986). Large Shareholders and Corporate Control. *Journal of Political Economy*, 94(3), pp.461–488.
- Short, H. & Keasey, K., (1999). Managerial ownership and the performance of firms: Evidence from the UK. *Journal of Corporate Finance*, 5(1), pp.79–101.
- Short, H., Zhang, H. & Keasey, K., (2002). The link between dividend policy and institutional ownership. *Journal of Corporate Finance*, 8(2), pp.105–122.
- Sikavica, K. & Kessler, E., (2013). Beyond External Constraints on Expropriation of Minority Investors: Preference Heterogeneity, Locus of Control and Firm Valuation. *SSRN Electronic Journal*, pp.1–45.
- Singal, M. & Singal, V., (2011). Concentrated ownership and firm performance: does family control matter? *Strategic Entrepreneurship Journal*, 396, pp.373–396.
- Slamen, K., Aljaaidi, Y. & Abidin, S. Bin, (2014). Auditor Industry Specialization and Concentration : Evidence from Kingdom of Saudi Arabia. *Journal of King Abdulaziz University : Economics and Administration*, 28(1), pp.347–382.
- Solomon, J., (2010). *Corporate governance and accountability* 3rd ed., Wiley: New York, NY.
- Su, Y., Xu, D. & Phan, P.H., (2008). Principal–Principal Conflict in the Governance of the Chinese Public Corporation. *Management and Organization Review*, 4(1), pp.17–38.
- Suchman, M.C., (1995). Managing Legitimacy: Strategic and Institutional Approaches. *The Academy of Management Review*, 20(3), pp.571–610.
- Sur, S., Lvina, E. & Magnan, M., (2013). Why do Boards Differ? Because Owners Do: Assessing Ownership Impact on Board Composition. *Corporate Governance: An International Review*, 21(4), pp.1–17.

- Tadawul, (2014). About Us. Available at:
<http://www.tadawul.com.sa/static/pages/en/Publication/PDF/Aboutus.pdf>.
- Thomsen, S. & Pedersen, T., (2000). Ownership structure and economic performance in the largest European companies. *Strategic Management Journal*, 705, pp.689–705.
- Thomsen, S., Pedersen, T. & Kvist, H.K., (2006). Blockholder ownership: Effects on firm value in market and control based governance systems. *Journal of Corporate Finance*, 12(2), pp.246–269.
- Tihanyi, L., Johnson, R. a., Hoskisson, R.E. & Hitt, M. a., (2003). Institutional Ownership Differences and International Diversification: the Effects of Boards of Directors and Technological Opportunity. *Academy of Management Journal*, 46(2), pp.195–211.
- Titman, S. & Trueman, B., (1986). Information quality and the valuation of new issues. *Journal of Accounting and Economics*, 8(2), pp.159–172.
- Tobin, J., (1958). Estimation of Relationships for Limited Dependent Variables. *Econometrica*, 26(1), pp.24–36.
- Torchia, A., (2016). Board of Saudi builder Mojil quits after three sentenced. *CNBC*, p.20/06/2016.
- Tricker, B., (1993). Corporate governance - the new focus of interest. *Corporate Governance: An International Review*, 1(1), pp.1–4.
- Truong, T. & Heaney, R., (2007). Largest shareholder and dividend policy around the world. *The Quarterly Review of Economics and Finance*, 47(5), pp.667–687.
- Villalonga, B. & Amit, R., (2006). How do family ownership, control and management affect firm value? *Journal of Financial Economics*, 80(2), pp.385–417.
- Viñals, J. & Ahmed, M., (2012). Saudi Arabia: Financial System Stability Assessment Update. *IMF Country Report No. 12/92*, April 2012
- Wang, K. & Shailer, G., (2015). Ownership Concentration and Firm Performance in Emerging Markets: a Meta-Analysis. *Journal of Economic Surveys*, 29(2), pp.199–229.
- Wang, K. & Xiao, X., (2011). Controlling shareholders' tunneling and executive compensation: Evidence from China. *Journal of Accounting and Public Policy*, 30(1), pp.89–100.
- Wang, Q., Wong, T.J. & Xia, L., (2008). State ownership, the institutional environment, and auditor choice: Evidence from China. *Journal of Accounting and Economics*, 46(1), pp.112–134.
- Wellalage, N. & Locke, S., (2015). Impact of ownership structure on capital structure of New Zealand unlisted firms. *Journal of Small Business and Enterprise Development*, 22(1), pp.127–142.
- Woidtke, T. & Yeh, Y.H., (2013). The role of the audit committee and the informativeness of accounting earnings in East Asia. *Pacific Basin Finance*

- Journal*, 23, pp.1–24.
- Wooldridge, J., (2010). *Econometric analysis of cross section and panel data*, The MIT Press: Cambridge.
- Wynbrandt, J., (2010). *A brief history of Saudi Arabia* 2nd Editio., Facts On File: New York.
- Yang, J.L., (2007). Saudi Arabia's stock collapse. *FORTUNE Magazine*, pp.17-01–2007.
- Yoshikawa, T., Zhu, H. & Wang, P., (2014). National Governance System, Corporate Ownership, and Roles of Outside Directors: A Corporate Governance Bundle Perspective. *Corporate Governance: An International Review*, 22(3), pp.252–265.
- Young, M., Peng, M., Ahlstrom, D., Bruton, G. & Jiang, Y., (2008). Corporate governance in emerging economies: A review of the principal–principal perspective. *Journal of Management Studies*, 45(1), pp.196–220.
- Zahra, S. & Pearce, J., (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of management*, 15(2), pp.291–334.
- Zattoni, A. & Judge, W., (2012). *Corporate Governance and Initial Public Offerings*, Cambridge University Press: Cambridge.
- ZAWYA, (2014). Saudi Stock Exchange. Available at:
<https://www.zawya.com/middle-east/financial-markets/saudi-arabia/>.
- Zuryati, Z. a, Azrae, A.N. & Yusoff, M., (2009). Separate legal entity under Syariah law and its application on Islamic banking in Malaysia : A note. *The International Journal of Banking and Finance*, 6(2), pp.139–154.

Appendix A – Saudi Corporate Governance Regulations (CGR)

CAPITAL MARKET AUTHORITY

CORPORATE GOVERNANCE REGULATIONS IN THE KINGDOM OF SAUDI ARABIA

Issued by the Board of Capital Market Authority
Pursuant to Resolution No. 1/212/2006
dated 21/10/1427AH (corresponding to 12/11/2006)
based on the Capital Market Law
issued by Royal Decree No. M/30
dated 2/6/1424AH

Amended by Resolution of the Board
of the Capital Market Authority Number 1-10-2010
Dated 30/3/1431H corresponding to 16/3/2010G

English Translation of the Official Arabic Text
Arabic is the official language of the Capital Market Authority

The current version of these Rules, as may be amended, can be found aton
the CMA website: www.cma.org.sa

CONTENTS

Part 1: Preliminary Provisions

- Article 1. Preamble
- Article 2. Definitions

Part 2: Rights of Shareholders and the General Assembly

- Article 3. General Rights of Shareholders
- Article 4. Facilitation of Shareholders' Exercise of Rights and Access to Information
- Article 5. Shareholders Rights related to the General Assembly
- Article 6. Voting Rights
- Article 7. Dividends Rights of Shareholders

Part 3: Disclosure and Transparency

- Article 8. Policies and Procedures related to Disclosure
- Article 9. Disclosure in the Board of Directors' Report

Part 4: Board of Directors

- Article 10. Main Functions of the Board
- Article 11. Responsibilities of the Board
- Article 12. Formation of the Board
- Article 13. Committees of the Board
- Article 14. Audit Committee
- Article 15. Nomination and Remuneration Committee
- Article 16. Meetings of the Board
- Article 17. Remuneration and Indemnification of Board Members
- Article 18. Conflict of Interest within the Board

Part 5: Closing Provisions

- Article 19. Publication and Entry into Force

PART 1 PRELIMINARY PROVISIONS

Article 1: Preamble

- a) These Regulations include the rules and standards that regulate the management of joint stock companies listed in the Exchange to ensure their compliance with the best governance practices that would ensure the protection of shareholders' rights as well as the rights of stakeholders.
- b) These Regulations constitute the guiding principles for all companies listed in the Exchange unless any other regulations, rules or resolutions of the Board of the Authority provide for the binding effect of some of the provisions herein contained.
- c) As an exception of paragraph (b) of this article, a company must disclose in the Board of Directors' report, the provisions that have been implemented and the provisions that have not been implemented as well as the reasons for not implementing them.

Article 2: Definitions

- a) Expression and terms in these regulations have the meanings they bear in the Capital Market Law and in the glossary of defined terms used in the regulations and the rules of the Capital Market Authority unless otherwise stated in these regulations.
- b) For the purpose of implementing these regulations, the following expressions and terms shall have the meaning they bear as follows unless the contrary intention appears:

Independent Member: A member of the Board of Directors who enjoys complete independence. By way of example, the following shall constitute an infringement of such independence:

1. he/she holds a five per cent or more of the issued shares of the company or any of its group.
2. Being a representative of a legal person that holds a five per cent or more of the issued shares of the company or any of its group.

3. he/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group.
4. he/she is a first-degree relative of any board member of the company or of any other company within that company's group.
5. he/she is first-degree relative of any of senior executives of the company or of any other company within that company's group.
6. he/she is a board member of any company within the group of the company which he is nominated to be a member of its board.
7. If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.

Non-executive director: A member of the Board of Directors who does not have a full-time management position at the company, or who does not receive monthly or yearly salary.

First-degree relatives: father, mother, spouse and children.

Stakeholders: Any person who has an interest in the company, such as shareholders, employees, creditors, customers, suppliers, community.

Accumulative Voting: a method of voting for electing directors, which gives each shareholder a voting rights equivalent to the number of shares he/she holds. He/she has the right to use them all for one nominee or to divide them between his/her selected nominees without any duplication of these votes. This method increases the chances of the minority shareholders to appoint their representatives in the board through the right to accumulate votes for one nominee.

Minority Shareholders: Those shareholders who represent a class of shareholders that does not control the company and hence they are unable to influence the company.

PART 2
RIGHTS OF SHAREHOLDERS AND THE GENERAL ASSEMBLY

Article 3: General Rights of Shareholders

A Shareholder shall be entitled to all rights attached to the share, in particular, the right to a share of the distributable profits, the right to a share of the company's assets upon liquidation; the right to attend the General Assembly and participate in deliberations and vote on relevant decisions; the right of disposition with respect to shares; the right to supervise the Board of Directors activities, and file responsibility claims against board members; the right to inquire and have access to information without prejudice to the company's interests and in a manner that does not contradict the Capital Market Law and the Implementing Rules.

Article 4: Facilitation of Shareholders Exercise of Rights and Access to Information

- a) The company in its Articles of Association and by-laws shall specify the procedures and precautions that are necessary for the shareholders' exercise of all their lawful rights.
- b) All information which enable shareholders to properly exercise their rights shall be made available and such information shall be comprehensive and accurate; it must be provided and updated regularly and within the prescribed times; the company shall use the most effective means in communicating with shareholders. No discrepancy shall be exercised with respect to shareholders in relation to providing information.

Article 5: Shareholders Rights related to the General Assembly

- a) A General Assembly shall convene once a year at least within the six months following the end of the company's financial year.
- b) The General Assembly shall convene upon a request of the Board of Directors. The Board of Directors shall invite a General Assembly to convene pursuant to a request of the auditor or a number of shareholders whose shareholdings represent at least 5% of the equity share capital.
- c) Date, place, and agenda of the General Assembly shall be specified and announced by a notice, at least 20 days prior to the date the meeting;

invitation for the meeting shall be published in the Exchange' website, the company's website and in two newspapers of voluminous distribution in the Kingdom. Modern high tech means shall be used in communicating with shareholders.

- d) Shareholders shall be allowed the opportunity to effectively participate and vote in the General Assembly; they shall be informed about the rules governing the meetings and the voting procedure.
- e) Arrangements shall be made for facilitating the participation of the greatest number of shareholders in the General Assembly, including *inter alia* determination of the appropriate place and time.
- f) In preparing the General Assembly's agenda, the Board of Directors shall take into consideration matters shareholders require to be listed in that agenda; shareholders holding not less than 5% of the company's shares are entitled to add one or more items to the agenda, upon its preparation.
- g) Shareholders shall be entitled to discuss matters listed in the agenda of the General Assembly and raise relevant questions to the board members and to the external auditor. The Board of Directors or the external auditor shall answer the questions raised by shareholders in a manner that does not prejudice the company's interest.
- h) Matters presented to the General Assembly shall be accompanied by sufficient information to enable shareholders to make decisions.
- i) Shareholders shall be enabled to peruse the minutes of the General Assembly; the company shall provide the Authority with a copy of those minutes within 10 days of the convening date of any such meeting.
- j) The Exchange shall be immediately informed of the results of the General Assembly.

Article 6: Voting Rights

- a) Voting is deemed to be a fundamental right of a shareholder, which shall not, in any way, be denied. The company must avoid taking any action which might hamper the use of the voting right; a shareholder

must be afforded all possible assistance as may facilitate the exercise of such right.

- b) In voting in the General Assembly for the nomination to the board members, the accumulative voting method shall be applied.
- c) A shareholder may, in writing, appoint any other shareholder who is not a board member and who is not an employee of the company to attend the General Assembly on his behalf.
- d) Investors who are judicial persons and who act on behalf of others - e.g. investment funds- shall disclose in their annual reports their voting policies, actual voting, and ways of dealing with any material conflict of interests that may affect the practice of the fundamental rights in relation to their investments.

Article 7: Dividends Rights of Shareholders

- a) The Board of Directors shall lay down a clear policy regarding dividends, in a manner that may realize the interests of shareholders and those of the company; shareholders shall be informed of that policy during the General Assembly and reference thereto shall be made in the report of the Board of Directors.
- b) The General Assembly shall approve the dividends and the date of distribution. These dividends, whether they be in cash or bonus shares shall be given, as of right, to the shareholders who are listed in the records kept at the Securities Depository Center as they appear at the end of trading session on the day on which the General Assembly is convened.

PART 3
DISCLOSURE AND TRANSPARENCY

Article 8: Policies and Procedure related to Disclosure

The company shall lay down in writing the policies, procedures and supervisory rules related to disclosure, pursuant to law.

Article 9 ¹: Disclosure in the Board of Directors' Report

In addition to what is required in the Listing Rules in connection with the content of the report of the Board of Directors, which is appended to the annual financial statements of the company, such report shall include the following:

- a) The implemented provisions of these Regulations as well as the provisions which have not been implemented, and the justifications for not implementing them.
- b) Names of any joint stock company or companies in which the company Board of Directors member acts as a member of its Board of directors.
- c) Formation of the Board of Directors and classification of its members as follows: executive board member, non-executive board member, or independent board member.
- d) A brief description of the jurisdictions and duties of the Board's main committees such as the Audit Committee, the Nomination and Remuneration Committee; indicating their names, names of their chairmen, names of their members, and the aggregate of their respective meetings.
- e) Details of compensation and remuneration paid to each of the following:

¹ The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 9 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from the first board report issued by the company following the date of the Board of the Capital Market Authority resolution mentioned above.

1. The Chairman and members of the Board of Directors.
2. The Top Five executives who have received the highest compensation and remuneration from the company. The CEO and the chief finance officer shall be included if they are not within the top five.

For the purpose of this paragraph, “compensation and remuneration” means salaries, allowances, profits and any of the same; annual and periodic bonuses related to performance; long or short- term incentive schemes; and any other rights *in rem*.

- f) Any punishment or penalty or preventive restriction imposed on the company by the Authority or any other supervisory or regulatory or judiciary body.
- g) Results of the annual audit of the effectiveness of the internal control procedures of the company.

PART 4

BOARD OF DIRECTORS

Article 10: Main Functions of the Board of Directors

Among the main functions of the Board is the following:

a) Approving the strategic plans and main objectives of the company and supervising their implementation; this includes:

1. Laying down a comprehensive strategy for the company, the main work plans and the policy related to risk management, reviewing and updating of such policy.
2. Determining the most appropriate capital structure of the company, its strategies and financial objectives and approving its annual budgets.
3. Supervising the main capital expenses of the company and acquisition/disposal of assets.
4. Deciding the performance objectives to be achieved and supervising the implementation thereof and the overall performance of the company.
5. Reviewing and approving the organizational and functional structures of the company on a periodical basis.

b) Lay down rules for internal control systems and supervising them; this includes:

1. Developing a written policy that would regulates conflict of interest and remedy any possible cases of conflict by members of the Board of Directors, executive management and shareholders. This includes misuse of the company's assets and facilities and the arbitrary disposition resulting from dealings with the related parties.
2. Ensuring the integrity of the financial and accounting procedures including procedures related to the preparation of the financial reports.

3. Ensuring the implementation of control procedures appropriate for risk management by forecasting the risks that the company could encounter and disclosing them with transparency.
 4. Reviewing annually the effectiveness of the internal control systems.
- c) Drafting a Corporate Governance Code for the company that does not contradict the provisions of this regulation, supervising and monitoring in general the effectiveness of the code and amending it whenever necessary.
 - d) Laying down specific and explicit policies, standards and procedures, for the membership of the Board of Directors and implementing them after they have been approved by the General Assembly.
 - e) Outlining a written policy that regulate the relationship with stakeholders with a view to protecting their respective rights; in particular, such policy must cover the following:
 1. Mechanisms for indemnifying the stakeholders in case of contravening their rights under the law and their respective contracts.
 2. Mechanisms for settlement of complaints or disputes that might arise between the company and the stakeholders.
 3. Suitable mechanisms for maintaining good relationships with customers and suppliers and protecting the confidentiality of information related to them.
 4. A code of conduct for the company's executives and employees compatible with the proper professional and ethical standards, and regulate their relationship with the stakeholders. The Board of Directors lays down procedures for supervising this code and ensuring compliance there with.
 5. The Company's social contributions.
 - f) Deciding policies and procedures to ensure the company's compliance with the laws and regulations and the company's obligation to disclose material information to shareholders, creditors and other stakeholders.

Article 11 : Responsibilities of the Board

- a) Without prejudice to the competences of the General Assembly, the company's Board of Directors shall assume all the necessary powers for the company's management. The ultimate responsibility for the company rests with the Board even if it sets up committees or delegates some of its powers to a third party. The Board of Directors shall avoid issuing general or indefinite power of attorney.
- b) The responsibilities of the Board of Directors must be clearly stated in the company's Articles of Association.
- c) The Board of Directors must carry out its duties in a responsible manner, in good faith and with due diligence. Its decisions should be based on sufficient information from the executive management, or from any other reliable source.
- d) A member of the Board of Directors represents all shareholders; he undertakes to carry out whatever may be in the general interest of the company, but not the interests of the group he represents or that which voted in favor of his appointment to the Board of Directors.
- e) The Board of Directors shall determine the powers to be delegated to the executive management and the procedures for taking any action and the validity of such delegation. It shall also determine matters reserved for decision by the Board of Directors. The executive management shall submit to the Board of Directors periodic reports on the exercise of the delegated powers.
- f) The Board of Directors shall ensure that a procedure is laid down for orienting the new board members of the company's business and, in particular, the financial and legal aspects, in addition to their training, where necessary.
- g) The Board of Directors shall ensure that sufficient information about the company is made available to all members of the Board of Directors, generally, and, in particular, to the non-executive members, to enable them to discharge their duties and responsibilities in an effective manner.

- h) The Board of Directors shall not be entitled to enter into loans which spans more than three years, and shall not sell or mortgage real estate of the company, or drop the company's debts, unless it is authorized to do so by the company's Articles of Association. In the case where the company's Articles of Association includes no provisions to this respect, the Board should not act without the approval of the General Assembly, unless such acts fall within the normal scope of the company's business.

Article 12²: Formation of the Board

Formation of the Board of Directors shall be subject to the following:

- a) The Articles of Association of the company shall specify the number of the Board of Directors members, provided that such number shall not be less than three and not more than eleven.
- b) The General Assembly shall appoint the members of the Board of Directors for the duration provided for in the Articles of Association of the company, provided that such duration shall not exceed three years. Unless otherwise provided for in the Articles of Association of the company, members of the Board may be reappointed.
- c) The majority of the members of the Board of Directors shall be non-executive members.
- d) It is prohibited to conjoin the position of the Chairman of the Board of Directors with any other executive position in the company, such as the Chief Executive Officer (CEO) or the managing director or the general manager.
- e) The independent members of the Board of Directors shall not be less than two members, or one-third of the members, whichever is greater.
- f) The Articles of Association of the company shall specify the manner in which membership of the Board of Directors terminates. At all times, the General Assembly may dismiss all or any of the members

² The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making paragraphs (c) and (e) of Article 12 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.

of the Board of Directors even though the Articles of Association provide otherwise.

- g) On termination of membership of a board member in any of the ways of termination, the company shall promptly notify the Authority and the Exchange and shall specify the reasons for such termination.
- h) A member of the Board of Directors shall not act as a member of the Board of Directors of more than five joint stock companies at the same time.
- i) Judicial person who is entitled under the company's Articles of Association to appoint representatives in the Board of Directors, is not entitled to nomination vote of other members of the Board of Directors.

Article 13: Committees of the Board

- a) A suitable number of committees shall be set up in accordance with the company's requirements and circumstances, in order to enable the Board of Directors to perform its duties in an effective manner.
- b) The formation of committees subordinate to the Board of Directors shall be according to general procedures laid down by the Board, indicating the duties, the duration and the powers of each committee, and the manner in which the Board monitors its activities. The committee shall notify the Board of its activities, findings or decisions with complete transparency. The Board shall periodically pursue the activities of such committees so as to ensure that the activities entrusted to those committees are duly performed. The Board shall approve the by-laws of all committees of the Board, including, *inter alia*, the Audit Committee, Nomination and Remuneration Committee.
- c) A sufficient number of the non-executive members of the Board of Directors shall be appointed in committees that are concerned with activities that might involve a conflict of interest, such as ensuring the integrity of the financial and non-financial reports, reviewing the deals concluded by related parties, nomination to membership of the Board, appointment of executive directors, and determination of remuneration.

Article 14³: Audit Committee

- a) The Board of Directors shall set up a committee to be named the “Audit Committee”. Its members shall not be less than three, including a specialist in financial and accounting matters. Executive board members are not eligible for Audit Committee membership.
- b) The General Assembly of shareholders shall, upon a recommendation of the Board of Directors, issue rules for appointing the members of the Audit Committee and define the term of their office and the procedure to be followed by the Committee.
- c) The duties and responsibilities of the Audit Committee include the following:
 - 1. To supervise the company’s internal audit department to ensure its effectiveness in executing the activities and duties specified by the Board of Directors.
 - 2. To review the internal audit procedure and prepare a written report on such audit and its recommendations with respect to it.
 - 3. To review the internal audit reports and pursue the implementation of the corrective measures in respect of the comments included in them.
 - 4. To recommend to the Board of Directors the appointment, dismissal and the Remuneration of external auditors; upon any such recommendation, regard must be made to their independence.
 - 5. To supervise the activities of the external auditors and approve any activity beyond the scope of the audit work assigned to them during the performance of their duties.
 - 6. To review together with the external auditor the audit plan and make any comments thereon.

³ The Board of the Capital Market Authority issued resolution Number (1-36-2008) Dated 12/11/1429H corresponding to 10/11/2008G making Article 14 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from year 2009.

7. To review the external auditor's comments on the financial statements and follow up the actions taken about them.
8. To review the interim and annual financial statements prior to presentation to the Board of Directors; and to give opinion and recommendations with respect thereto.
9. To review the accounting policies in force and advise the Board of Directors of any recommendation regarding them.

Article 15⁴: Nomination and Remuneration Committee

- a) The Board of Directors shall set up a committee to be named "Nomination and Remuneration Committee".
- b) The General Assembly shall, upon a recommendation of the Board of Directors, issue rules for the appointment of the members of the Nomination and Remuneration Committee, their remunerations, and terms of office and the procedure to be followed by such committee.
- c) The duties and responsibilities of the Nomination and Remuneration Committee include the following:
 1. Recommend to the Board of Directors appointments to membership of the Board in accordance with the approved policies and standards; the Committee shall ensure that no person who has been previously convicted of any offense affecting honor or honesty is nominated for such membership.
 2. Annual review of the requirement of suitable skills for membership of the Board of Directors and the preparation of a description of the required capabilities and qualifications for such membership, including, *inter alia*, the time that a Board member should reserve for the activities of the Board.
 3. Review the structure of the Board of Directors and recommend changes.

⁴ The Board of the Capital Market Authority issued resolution Number (1-10-2010) Dated 30/3/1431H corresponding to 16/3/2010G making Article 15 of the Corporate Governance Regulations mandatory on all companies listed on the Exchange effective from 1/1/2011

4. Determine the points of strength and weakness in the Board of Directors and recommend remedies that are compatible with the company's interest.
5. Ensure on an annual basis the independence of the independent members and the absence of any conflict of interest in case a Board member also acts as a member of the Board of Directors of another company.
6. Draw clear policies regarding the indemnities and remunerations of the Board members and top executives; in laying down such policies, the standards related to performance shall be followed.

Article 16: Meetings of the Board

1. The Board members shall allot ample time for performing their responsibilities, including the preparation for the meetings of the Board and the permanent and ad hoc committees, and shall endeavor to attend such meetings.
2. The Board shall convene its ordinary meetings regularly upon a request by the Chairman. The Chairman shall call the Board for an unforeseen meeting upon a written request by two of its members.
3. When preparing a specified agenda to be presented to the Board, the Chairman should consult the other members of the Board and the CEO. The agenda and other documentation should be sent to the members in a sufficient time prior to the meeting so that they may be able to consider such matters and prepare themselves for the meeting. Once convened, the Board shall approve the agenda; should any member of the Board raise any objection to this agenda, the details of such objection shall be entered in the minutes of the meeting.
4. The Board shall document its meetings and prepare records of the deliberations and the voting, and arrange for these records to be kept in chapters for ease of reference.

Article 17: Remuneration and Indemnification of Board Members

The Articles of Association of the company shall set forth the manner of remunerating the Board members; such remuneration may take the form of a

lump sum amount, attendance allowance, rights *in rem* or a certain percentage of the profits. Any two or more of these privileges may be conjoined.

Article 18. Conflict of Interest within the Board

- a) A Board member shall not, without a prior authorization from the General Assembly, to be renewed each year, have any interest (whether directly or indirectly) in the company's business and contracts. The activities to be performed through general bidding shall constitute an exception where a Board member is the best bidder. A Board member shall notify the Board of Directors of any personal interest he/she may have in the business and contracts that are completed for the company's account. Such notification shall be entered in the minutes of the meeting. A Board member who is an interested party shall not be entitled to vote on the resolution to be adopted in this regard neither in the General Assembly nor in the Board of Directors. The Chairman of the Board of Directors shall notify the General Assembly, when convened, of the activities and contracts in respect of which a Board member may have a personal interest and shall attach to such notification a special report prepared by the company's auditor.
- b) A Board member shall not, without a prior authorization of the General Assembly, to be renewed annually, participate in any activity which may likely compete with the activities of the company, or trade in any branch of the activities carried out by the company.
- c) The company shall not grant cash loan whatsoever to any of its Board members or render guarantee in respect of any loan entered into by a Board member with third parties, excluding banks and other fiduciary companies.

PART 5
CLOSING PROVISIONS

Article 19: Publication and Entry into Force

These regulations shall be effective upon the date of their publication.